

**LEGAL NOTICE REGARDING**  
**\$525,000,000**  
**TENNESSEE VALLEY AUTHORITY**  
**POWER BONDS 1999 SERIES A DUE MAY 1, 2029**  
**(PUTABLE AUTOMATIC RATE RESET SECURITIES)**

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TVA is issuing this legal notice (1) to clarify the procedures that you should follow in order to put Tennessee Valley Authority Power Bonds 1999 Series A Due May 1, 2029 (Putable Automatic Rate Reset Securities) (the “Bonds”) back to TVA in the event that a Coupon Rate reset notice is given and (2) to clarify the procedures used to determine whether the Coupon Rate on the Bonds will be reset. Unless otherwise defined herein, all capitalized terms in this legal notice shall have the meanings assigned to them in the offering circular relating to the Bonds dated April 29, 1999 (the “Offering Circular”).

**Changes to Put Procedures**

TVA has waived the requirement that the Summary Election Form and the Option to Elect Repayment Form be completed and submitted in accordance with the instructions regarding those two forms contained in the Offering Circular. Accordingly, you no longer need to notify TVA of your exercise of the put option, and no forms need to be provided to TVA regarding your exercise of this option.

If you wish to exercise the put option in the event that a Coupon Rate reset notice is given, you must still comply with the instructions provided by The Depository Trust Company (“DTC”) regarding the exercise of the put option. These instructions can be obtained from DTC through the Financial Institution through which you beneficially hold your Bonds.

It is your responsibility to notify your Financial Institution that you are requesting repayment and are authorizing your Financial Institution to make arrangements, on your behalf, with DTC for the exercise of the put option. These arrangements with DTC must be completed ***no earlier than*** the relevant Reset Notification Date and ***no later than*** April 21 (or the prior Business Day, if such date is not a Business Day) of the year of such Reset Notification Date. It is also your responsibility to determine from your Financial Institution the amount of advance notice it needs from you to complete arrangements with

DTC to properly exercise the put option within the time period described above. In addition, you are responsible for ensuring that your Financial Institution completes the necessary arrangements with DTC, including any timely notice to DTC and timely delivery of your Bonds to TVA through DTC's book-entry system. If your Financial Institution does not properly complete all necessary arrangements with DTC regarding the timely exercise of the put option, TVA shall not be obligated to honor your request to put your Bonds.

If you do not wish to exercise the put option in the event that a Coupon Rate reset notice is given, no action is required. However, it is recommended that you discuss any such option with a qualified financial advisor.

### **Changes in Coupon Rate Reset Procedures**

The Offering Circular provides that the CMT will be used to determine whether the Coupon Rate will be reset. The Offering Circular also provides that if the CMT is discontinued or materially altered while the Bonds are outstanding, TVA may, in its sole discretion, substitute an alternative index that TVA believes most closely resembles the CMT before it was discontinued or altered. Since the CMT was discontinued on February 18, 2002, and reintroduced on February 9, 2006, TVA substituted an estimated 30-year rate for the CMT during this time; however, effective immediately, TVA will begin using the CMT again as originally provided for in the Offering Circular to determine whether the Coupon Rate will be reset. The CMT can currently be found on the United States Treasury's web site at:

<http://www.treas.gov/offices/domestic-finance/debt-management/interest-rate/yield.shtml>

If you have any questions about the procedures for putting your Bonds back to TVA or the way in which TVA will determine whether the Coupon Rate will be reset, please call TVA Investor Relations at 888-882-4975.

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This legal notice was originally dated March 18, 2004, and was updated on March 31, 2005, and on February 24, 2006.

## OFFERING CIRCULAR

# \$450,000,000

# Tennessee Valley Authority

POWER BONDS 1999 SERIES A DUE MAY 1, 2029  
(PUTABLE AUTOMATIC RATE RESET SECURITIES)



*The Tennessee Valley Authority Power Bonds 1999 Series A Due May 1, 2029 (Putable Automatic Rate Reset Securities) (the "Bonds" — sometimes called "PARRS") will have the following terms. For more detail, see "Description of Bonds".*

- The Tennessee Valley Authority ("TVA") — a corporation owned by the United States of America — is the issuer.
- TVA will make payment of principal and interest solely from its Net Power Proceeds (as defined in "Description of Bonds" — "General").
- The Depository Trust Company ("DTC") will maintain and transfer the Bonds as book-entry securities.
- The Bonds will be available for purchase in denominations of \$25.
- TVA has applied to list the Bonds on the New York Stock Exchange. See "Underwriters".
- The Bonds have been rated Aaa by Moody's Investors Service and AAA by Standard & Poor's.
- Principal and interest on the Bonds generally are exempt from state and local income taxes. See "Tax Matters".
- TVA may not redeem the Bonds prior to maturity.
- TVA will pay interest each February 1, May 1, August 1 and November 1, beginning August 1, 1999.
- The rate at which the Bonds bear interest (the "Coupon Rate") may be reset to a lower rate beginning May 1, 2004, and annually thereafter.
- The initial Coupon Rate will be 6.50%.
- If the Coupon Rate is reset to a lower rate, you can put (return) any or all of your Bonds to TVA and receive \$25 for each Bond you put.

*Investment in the Bonds involves certain risks. You bear all risks associated with investment in the Bonds. See "Risk Factors" on page C-8.*

*The Bonds are not obligations of the United States of America, and it does not guarantee the payment of the principal of or the interest on the Bonds. TVA is not required to register the Bonds under the Securities Act of 1933 or to make reports to the Securities and Exchange Commission under the Securities Exchange Act of 1934. TVA does not intend to register the Bonds or file any reports with the Securities and Exchange Commission.*

	Price to Public (1)	Underwriting Discounts and Commissions	Proceeds to TVA (1) (2)
Per Bond .....	100.00%	3.10%	96.90%
Total (3) .....	\$450,000,000	\$13,950,000	\$436,050,000

(1) Plus accrued interest from May 6, 1999 to date of delivery.

(2) Before deducting expenses payable by TVA estimated at \$250,000.

(3) TVA has granted to the Underwriters a three Business Day option to purchase, on the same terms set forth above, up to \$90,000,000 aggregate principle amount of additional PARRS at the initial price to public (less the underwriting discounts and commissions) solely to cover over-allotments, if any. If the option is exercised in full, the total initial price to public, underwriting discounts and commissions and proceeds to TVA will be \$540,000,000, \$16,740,000 and \$523,260,000, respectively.

*The Underwriters are required to purchase all of the Bonds if they purchase any of the Bonds. Morgan Stanley & Co. Incorporated expects the Bonds will be delivered to purchasers on May 6, 1999.*

**MORGAN STANLEY DEAN WITTER**

**A.G. EDWARDS & SONS, INC.**

**FIRST TENNESSEE BANK N.A.**

**PAINEWEBBER INCORPORATED**

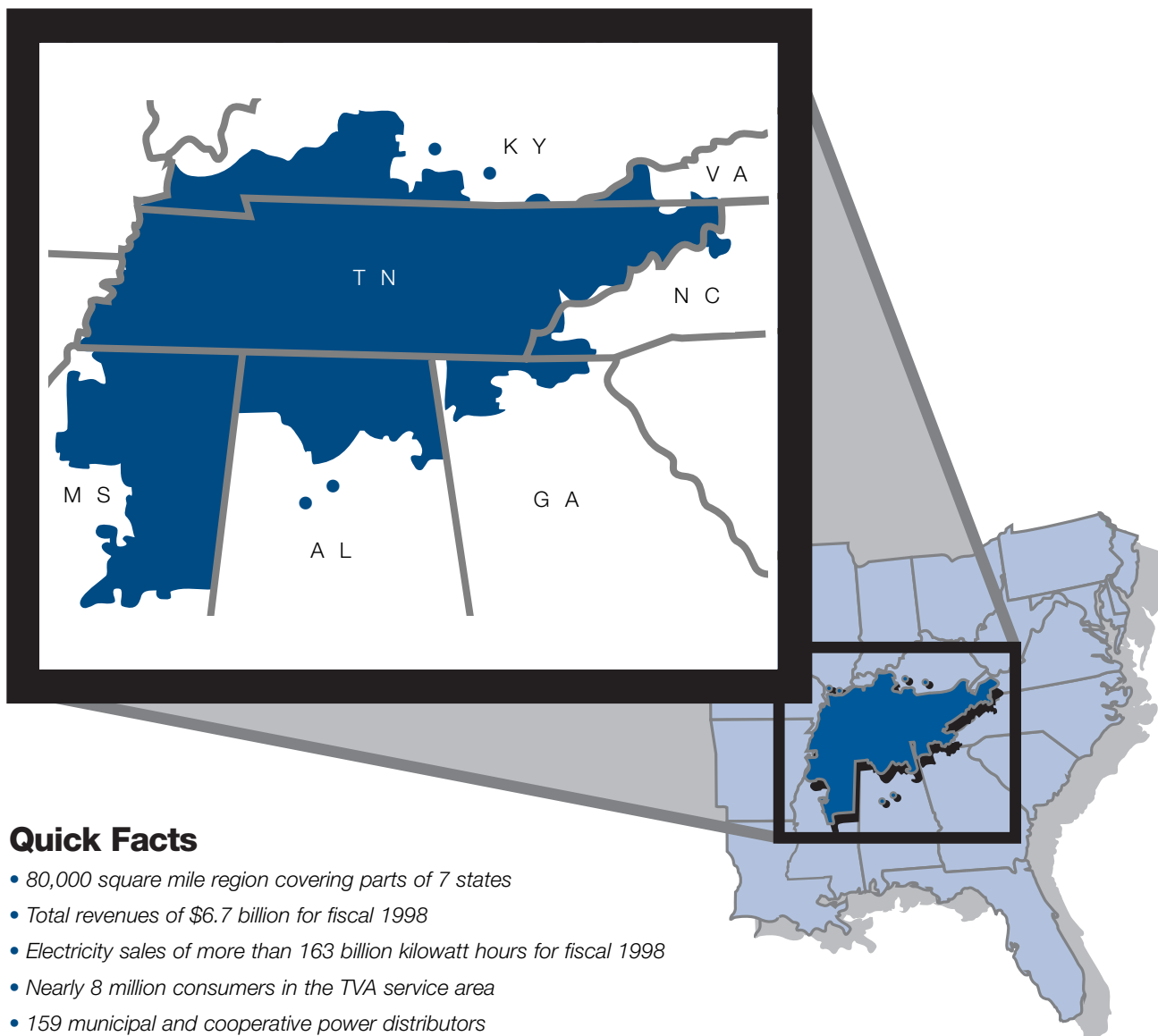
**PRUDENTIAL SECURITIES INCORPORATED**

April 29, 1999

## TVA Overview

The Tennessee Valley Authority ("TVA") is a U.S. Government-owned corporation established by Congress in 1933. It is the nation's largest wholesale power producer and maintains a net winter dependable capacity of 28,498 megawatts. TVA also maintains about 17,000 miles of transmission lines, and manages the nation's fifth-largest river system for flood control, navigation, power production and recreation.

## The Tennessee Valley Authority Service Area



## Quick Facts

- 80,000 square mile region covering parts of 7 states
- Total revenues of \$6.7 billion for fiscal 1998
- Electricity sales of more than 163 billion kilowatt hours for fiscal 1998
- Nearly 8 million consumers in the TVA service area
- 159 municipal and cooperative power distributors
- 64 directly-served industrial and federal customers
- New York Stock Exchange symbols

Bond Market Symbol	"TVA"
QIDS	"TVA" (Tn Vly QIDS 45, 8.00%)
	"TVB" (Tn Vly QIDS 46, 7.50%)
PARRS	"TVC" (Tn Vly PARRS 28, 6.75%)





# PROVIDING POWER IN THE PUBLIC INTEREST

**TVA is poised to be a competitive player in what is predicted to be a new, highly competitive electric**



**utility market.**

**With one of**

**the largest**

**generating**

**and transmis-**

**sion systems in the United**

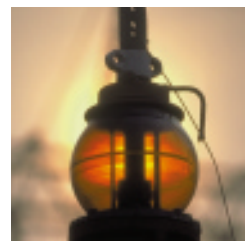
**States, TVA's power operations**

**form a vital part of the nation's**

**energy infrastructure.**



TVA is recognized around the world as an expert in power production, flood control, river navigation, and environmental quality. TVA provides reliable, universal access to electricity at competitive prices and provides stewardship of the lands and waters of the Tennessee River Valley. TVA power enriches lives, promotes economic growth, and improves the overall quality of life in the Tennessee Valley.



TVA's power system is entirely self-funded. The power system is running better today than at any time in the past decade. TVA's ability to meet peak demands in summer and winter is due largely to ongoing efficiency improvements and the fact that TVA is one of the few utilities to add generating capacity in the past three years—and the only one to add nuclear capacity in the past five years. On June 24, 1998, TVA met an all-time-high

peak demand of 27,253 megawatts. TVA carries out other programs mandated by the U.S. Congress, such as economic development, flood control, navigation and natural resource development on the Tennessee River.

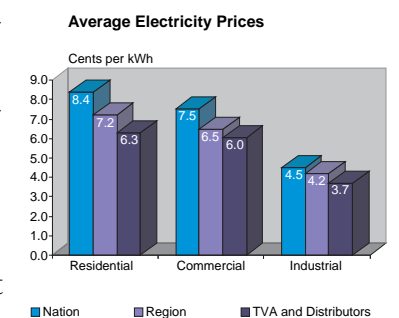
TVA unveiled an ambitious 10-year Business Plan in July 1997 that is designed to strengthen it financially, position the electric power operations to meet the competitive challenges of a restructured marketplace, promote economic development and provide power to its customers at the lowest feasible rates. This plan sets a focused course for TVA to lower its average cost of power to the projected market price of power in 2007.

The 10-year Business Plan is designed to accomplish long-term objectives that would enable TVA to be competitive in the com-

ing restructured marketplace by:

- Reducing the cost of power as needed to meet the lower market prices anticipated in a more competitive market.
- Altering TVA's cost structure from a high fixed-to-variable cost relationship to a more flexible structure better suited to a volatile, competitive market.
- Strengthening customer allegiance and satisfaction by developing opportunities for mutual support and partnerships.

TVA is committed to serving the public good—through economic development, reliable service, environmental stewardship and universal access. TVA, as a government owned power entity, is an advocate for the public interest in electricity generation, transmission and distribution as the electric utility industry is restructured.



SOURCE: Energy Information Administration and TVA, average price data for 7/97 through 6/98



***You should rely only on the information contained in this Offering Circular and the attached Information Statement dated February 16, 1999 (the “current Information Statement”). We have not authorized anyone to provide you with information that is different.***

You should read this Offering Circular together with the current Information Statement. This Offering Circular and the current Information Statement are accurate only as of the date of each. TVA assumes no duty to update the Offering Circular or the current Information Statement after the date of each. You should rely on information in the Offering Circular over different information in the current Information Statement.

You may request additional copies of this Offering Circular and the current Information Statement in writing or by telephone:

Tennessee Valley Authority  
400 West Summit Hill Drive  
Knoxville, Tennessee 37902  
Attention: Vice President and Treasurer  
Telephone: (423) 632-3366.

You may inspect the Offering Circular and the current Information Statement and other information concerning TVA at the offices of the New York Stock Exchange, 20 Broad Street, New York, New York 10005.

This Offering Circular does not constitute an offer to sell or a solicitation of an offer to buy the Bonds in any jurisdiction to any person to whom it is unlawful to make an offer or solicitation.

## **FORWARD-LOOKING STATEMENTS**

This Offering Circular and the current Information Statement contain forward-looking statements relating to future events and future performance. Any statements regarding expectations, beliefs, plans, projections, estimates, objectives, intentions or assumptions or otherwise relating to future events or performance may be forward-looking.

Some examples of forward-looking statements include statements regarding TVA's projections of future power and energy requirements, future costs related to environmental compliance, targets for TVA's future competitive position, and the potential effect of the Year 2000 issue on TVA's operations. Although TVA believes that the assumptions underlying the forward-looking statements in this Offering Circular and the current Information Statement are reasonable, TVA does not guarantee the accuracy of these statements.

Numerous factors could cause actual results to differ materially from those in the forward-looking statements. These factors include, among other things, new laws and regulations, especially those related to the restructuring of electric utilities and various environmental matters; increased competition among electric utilities; legal and administrative proceedings affecting TVA; the financial environment; performance of TVA's generating facilities; fuel prices; the demand for electricity; weather conditions; changes in accounting standards; the efficacy of TVA's Year 2000 remediation efforts and the efforts of those entities with which TVA interfaces; and unforeseeable events.

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## SUMMARY OF OFFERING

*Because this is a summary, it does not contain all the information that may be important to you. You should carefully read the entire Offering Circular together with the current Information Statement. Capitalized terms used and not defined in this section have the meanings defined elsewhere in the Offering Circular and current Information Statement.*

### Issuer

TVA is a wholly owned corporate agency and instrumentality of the United States of America established by the Tennessee Valley Authority Act of 1933, as amended.

### Securities Offered

\$450,000,000 aggregate principal amount of Tennessee Valley Authority Power Bonds 1999 Series A Due May 1, 2029 (Putable Automatic Rate Reset Securities).

### Interest Rate

TVA will pay interest on the Bonds from May 6, 1999, quarterly in arrears on each February 1, May 1, August 1 and November 1, beginning August 1, 1999. The initial Coupon Rate of the Bonds will be 6.50%. Beginning May 1, 2004 and on the same date each year thereafter, the Coupon Rate will be reset to a lower rate, if on the Calculation Date the CMT (as defined in “Description of Bonds” — “Interest Computation”) plus 0.84% is lower than the Coupon Rate in effect on the Calculation Date. The new Coupon Rate will apply until there is another reset, if any. See “Risk Factors” and “Description of Bonds” — “Interest Computation”.

### Redemption

TVA may not redeem the Bonds prior to maturity.

### Put Option

Whenever the Coupon Rate is reset to a lower rate, you can put (return) your Bonds to TVA. TVA will pay \$25 for each Bond you properly put. To put your Bonds to TVA, you must arrange for the broker or other financial institution through which you hold your Bonds (your “Financial Institution”) to notify TVA. Your Financial Institution will also be required to have any Bonds you decide to put delivered by the deadlines set forth under

“Description of Bonds” — “Put Option” and to comply with the instructions accompanying the Summary Election Form and the Option to Elect Repayment Form attached to this Offering Circular. See “Description of Bonds” — “Put Option”.

### Repayment

TVA will repay the Bonds at par (\$25) on the Maturity Date or on the date you properly put your Bonds to TVA. TVA will pay interest separately as described in “Description of Bonds” — “Payment of Principal and Interest”.

### Depository

DTC will act as the securities depository for the Bonds.

### Listing

TVA has applied to list the Bonds on the New York Stock Exchange.

### Ratings

The Bonds have been rated Aaa by Moody's Investors Service and AAA by Standard & Poor's.

### Use of Proceeds

TVA will use the net proceeds from the sale of the Bonds to retire existing debt.

### Source of Payment

TVA will pay the interest and principal on the Bonds solely from its Net Power Proceeds. The Bonds are not obligations of or guaranteed by the United States. See “The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness” in the current Information Statement.

### Form and Denomination of Bonds

The Bonds will be issued and maintained, and may be transferred only by Direct Participants, on

the book-entry system of DTC. See “Description of Bonds” — “Book-Entry System”. Except in limited circumstances, you will not be able to exchange the Bonds for definitive securities. The Bonds will be issued, maintained and transferred in principal amounts of \$25.

#### **Legality of Investment**

The laws of some jurisdictions limit the type and amount of securities that certain institutional investors may acquire. You should consult with your own counsel regarding legality of investment in the Bonds. The Bonds could be subject to certain restrictions or requirements as to legality of investment that do not apply to Power Bonds with fixed rates of interest. Generally, Power Bonds *with fixed rates of interest* are:

- acceptable as security for all fiduciary, trust and public funds, the investment or deposit of which is under the authority or control of any officer or agency of the United States;
- obligations that national banks may deal in, underwrite and buy for their own accounts in amounts up to 10% of their unimpaired capital and surplus;
- eligible as collateral for advances by Federal Reserve Banks to member banks;
- legal investments for federal savings associations and federal savings banks to the extent specified in applicable regulations;
- eligible as collateral for advances by Federal Home Loan Banks to members for which Power Bonds are legal investments; and
- legal investments for federal credit unions.

See “Legality of Investment”.

#### **No Acceleration Right**

You may not accelerate the maturity of the Bonds upon any default. See “The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness” — “Events of Default” in the current Information Statement.

#### **Taxation**

The Bonds are subject to various tax consequences. Principal and interest on the Bonds are generally exempt from state and local income taxes. See “Tax Matters”.

#### **CUSIP Number**

880591 409

## RISK FACTORS

If you invest in the Bonds, you are subject to risk factors not associated with investments in typical fixed-interest rate or floating-interest rate securities:

- *Rate Reset.* The Coupon Rate at which the Bonds bear interest, though initially set at 6.50%, may be reset beginning May 1, 2004, and annually thereafter to a lower rate. The Coupon Rate will never be adjusted upward. For details on how the Coupon Rate is calculated, see “Description of Bonds” — “Interest Computation”.
- *Trading Market.* The Bonds are a new issue with no established trading market. The Underwriters have advised TVA that they presently intend to make a market in the Bonds, as permitted by applicable laws and regulations. The Underwriters are not obligated, however, to make a market in the Bonds, and they may discontinue any such market making at any time at their sole discretion. Accordingly, no assurance can be given as to the liquidity of, or trading markets for, the Bonds.
- *Required Representations and Indemnification.* The Option to Elect Repayment Form and the accompanying instructions require the broker or other financial institution through which you beneficially hold your Bonds (your “Financial Institution”) to make certain representations and agree to certain terms, including the indemnification of TVA against certain losses and costs. If your Financial Institution will not make such representations or will not agree to such terms, TVA will not be obligated to honor your request for repayment. See “Description of Bonds” — “Put Option”.
- *Put Procedures.* If your Financial Institution does not put your Bonds to TVA in accordance with the procedures and time limits described in “Description of Bonds” — “Put Option” and in the Summary Election Form and the accompanying instructions, TVA will not be obligated to honor your request to put the Bonds.

You bear these and all other risks which may be associated with investment in the Bonds.

## QUESTIONS AND ANSWERS ABOUT TVA'S PARRS

*These questions and answers do not provide all information that may be important to you. You should carefully read the entire Offering Circular together with the current Information Statement. Capitalized terms used in this section and not defined have the meanings defined elsewhere in the Offering Circular and current Information Statement.*

### **Q: Are principal and interest taxable?**

Both principal and interest on the Bonds are generally exempt from state and local tax, except estate, inheritance and gift taxes. The Bonds are not exempt from federal income tax.

### **Q: Can I receive a certificate for my Bonds?**

No, except in limited circumstances. The Bonds will be represented by Global Securities deposited with DTC and will be held only on DTC's book-entry system in book-entry form. Unless you are a Direct Participant in DTC's book-entry system, you will hold your Bonds indirectly through one or more financial intermediaries such as banks, brokerage firms and securities clearing organizations. Only if the book-entry system is discontinued and TVA selects no substitute depository will certificated Bonds be issued.

### **Q: How will the Coupon Rate change over the life of the Bonds?**

Beginning May 1, 2004, and on the same date each year, the Coupon Rate will be reset to a lower rate if the 30-year CMT, for the week ending the last Friday in March, plus 0.84% is less than the Coupon Rate then in effect.

### **Q: How can I calculate the reset Coupon Rate?**

The rate used to calculate the reset is the CMT for the week ending the last Friday in March beginning with the week ending March 26, 2004. The CMT is the rate published in "Statistical Release H.15(519), 'Selected Interest Rates'" or any successor publication, published by the Board of Governors of the Federal Reserve System under the heading "U.S. government securities — Treasury constant maturities — 30-year". This publication is located on the Internet at [www.bog.frb.fed.us/releases/h15](http://www.bog.frb.fed.us/releases/h15). The 30-year CMT average for the week can also be found every Tuesday in *The Wall Street Journal*, Section C, under "Key Interest Rates". The reset Coupon Rate will be the sum of the relevant CMT plus 0.84%.

### **Q: If the Coupon Rate is reset downward, can it go up later?**

No. The Coupon Rate may only be adjusted downward. If the Coupon Rate is reset to a lower rate, you have the option to put your Bonds to TVA and receive \$25 for each Bond.

### **Q: What happens to the Coupon Rate on the Bonds in the first five years?**

The Coupon Rate on the Bonds will not change in the first five years.

### **Q: Can TVA call my Bonds?**

No. TVA cannot call the Bonds.

### **Q: How will I be notified if the Coupon Rate is reset?**

TVA will send notice of reset to DTC. Unless you are a Direct Participant in DTC's book-entry system, you should make arrangements with your Financial Institution holding your Bonds to receive reset notices.

### **Q: When can I put (return) the Bonds?**

You can put your Bonds to TVA on any date when the Coupon Rate is reset (or the next succeeding Business Day, if such date is not a Business Day).

You are responsible for arranging to have your Financial Institution send the "Summary Election Form" and the "Option to Elect Repayment Form" (found in this Offering Circular) to TVA. TVA must receive these forms no later than April 21 of the year the relevant Coupon Rate reset will occur (or the prior Business Day, if such date is not a Business Day).

### **Q: How will the Bonds rank compared to TVA's other debt?**

The Bonds will rank equal to TVA's other outstanding Power Bonds.

### **Q: When is the last day to purchase the Bonds to receive the next quarterly interest payment?**

To receive payment, you must hold your Bonds on the record date (the Business Day immediately before the relevant Interest Payment Date).

### **Q: Can I purchase Bonds directly from TVA?**

No. You must purchase your Bonds through a broker or other proper financial intermediary.

### **Q: Are the Bonds backed by the U.S. Government?**

No. The Bonds are not obligations of or guaranteed by the U.S. Government.

## TENNESSEE VALLEY AUTHORITY

The Tennessee Valley Authority is one of the largest power producers in the United States of America, having produced over 155 billion kilowatt-hours (“kWh”) of electricity in fiscal 1998. The TVA system supplies electric power to a region containing nearly eight million people located in parts of Tennessee, Kentucky, Mississippi, Alabama, Georgia, North Carolina and Virginia.

TVA is a wholly owned corporate agency and instrumentality of the United States of America established pursuant to the Tennessee Valley Authority Act of 1933, as amended (the “Act”), primarily to develop and manage the resources of the Tennessee Valley region. Historically, the programs at TVA have consisted of power and nonpower programs. The Act requires TVA’s electric system operations to be self-supporting from power system revenues, which were about \$6.7 billion in fiscal 1998. Congress does not appropriate funds to TVA for its power program. The Act authorizes TVA to issue Evidences of Indebtedness (as defined in “Description of Bonds”), the proceeds of which TVA may only use to finance its power program. TVA’s nonpower activities have included responsibilities associated with operation of the Tennessee River system, land management, economic development and the environment. While Congress historically has appropriated amounts to fund TVA’s nonpower programs (including \$50 million for fiscal 1999), Congress passed legislation in 1997 providing for the funding of these programs with revenues from TVA’s power program and other TVA revenue sources. See “The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness” — “Recent Legislation” in the current Information Statement.

For over six decades, TVA has been associated with bringing prosperity to a significant region of the United States. Its dams have averted an estimated \$4 billion in flood damage; its power program has brought electricity to a large undeveloped area of the country; and its economic development program has contributed to a vast increase in the number of jobs in the Tennessee Valley.

Electric power industry restructuring is changing the way TVA and utilities across the nation generate, transmit and distribute electricity. TVA is positioning itself to successfully compete in a restructured marketplace by sustaining excellent operational performance and achieving greater financial flexibility. Building on its operational soundness, TVA implemented its Ten-Year Business Plan in October 1997 to reduce its total delivered cost of power consistent with the forecast future market price of power and adopt a more flexible cost structure suitable for an increasingly volatile marketplace. See “Competition” in the current Information Statement.

TVA is an advocate for the public’s interest in universal access, customer service and reliability, economic development and environmental protection. TVA will continue to work actively with Congress to ensure that these standards are upheld through the development of an equitable, effective framework for success in a restructured marketplace.

## USE OF PROCEEDS

TVA will use the net proceeds from the sale of the Bonds to retire existing debt.

## RECENT DEVELOPMENTS

### Financial Results

TVA has derived the condensed financial statements for TVA’s power program for the fiscal years ended September 30, 1998 and 1997 from TVA’s audited financial statements. The condensed financial statements for TVA’s power program for the six months ended March 31, 1999 and 1998 are unaudited, but in the opinion of management of TVA include all adjustments (consisting only of normal recurring adjustments) necessary for the fair presentation of results for such periods. You should read the following information together with the audited financial statements and notes thereto in the current Information Statement. Results for the six months ended March 31, 1999 and for past years are not necessarily indicative of future results.

**TENNESSEE VALLEY AUTHORITY  
POWER PROGRAM  
CONDENSED BALANCE SHEETS  
At March 31, 1999 and September 30, 1998**

	March 31, 1999	September 30, 1998
	(Millions)	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents . . . . .	\$ 9	\$ 391
Accounts receivable . . . . .	571	796
Inventories and other, at average cost . . . . .	505	469
Total current assets . . . . .	1,085	1,656
PROPERTY, PLANT, AND EQUIPMENT		
Completed plant . . . . .	29,292	29,055
Less accumulated depreciation . . . . .	(8,343)	(7,945)
Net completed plant . . . . .	20,949	21,110
Construction in progress . . . . .	581	548
Deferred nuclear generating units . . . . .	6,316	6,311
Nuclear fuel and capital lease assets . . . . .	626	922
Total property, plant, and equipment . . . . .	28,472	28,891
INVESTMENT FUNDS . . . . .	724	578
DEFERRED CHARGES AND OTHER ASSETS . . . . .	2,657	2,490
Total assets . . . . .	<u>\$32,938</u>	<u>\$33,615</u>
LIABILITIES AND PROPRIETARY CAPITAL		
CURRENT LIABILITIES		
Accounts payable . . . . .	\$ 363	\$ 521
Accrued liabilities . . . . .	154	175
Accrued interest . . . . .	464	487
Short-term debt . . . . .	1,877	1,757
Current maturities of long-term debt . . . . .	1,000	1,500
Total current liabilities . . . . .	3,858	4,440
OTHER LIABILITIES . . . . .	2,123	2,007
LONG-TERM DEBT		
Public bonds — senior . . . . .	22,267	19,127
Federal Financing Bank — senior . . . . .	—	3,200
Public bonds — subordinated . . . . .	1,100	1,100
Unamortized discount and other adjustments . . . . .	(495)	(407)
Total long-term debt . . . . .	22,872	23,020
PROPRIETARY CAPITAL		
Appropriation investment . . . . .	558	568
Retained earnings reinvested in power program . . . . .	3,527	3,580
Total proprietary capital . . . . .	4,085	4,148
Total liabilities and proprietary capital . . . . .	<u>\$32,938</u>	<u>\$33,615</u>



**TENNESSEE VALLEY AUTHORITY  
POWER PROGRAM**

**CONDENSED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS**

**For the Six Months Ended March 31, 1999 and 1998**

**and for the Years Ended September 30, 1998 and 1997**

	Six Months Ended March 31,		Years Ended September 30,	
	1999	1998(1)	1998	1997
	(Millions)			
<b>OPERATING REVENUES</b>				
Sales of electricity				
Municipalities and cooperatives .....	\$2,565	\$2,580	\$5,554	\$4,811
Industries directly served .....	306	242	523	464
Federal agencies and other .....	139	265	556	561
Other .....	32	34	96	98
Total operating revenues .....	<u>3,042</u>	<u>3,121</u>	<u>6,729</u>	<u>5,934</u>
<b>OPERATING EXPENSES</b>				
Fuel and purchased power .....	768	822	1,900	1,593
Operating and maintenance .....	676	674	1,347	1,201
Depreciation and amortization .....	806	517	1,038	1,014
Tax-equivalents .....	148	131	264	272
Total operating expenses .....	<u>2,398</u>	<u>2,144</u>	<u>4,549</u>	<u>4,080</u>
<b>OPERATING INCOME</b> .....	<u>644</u>	<u>977</u>	<u>2,180</u>	<u>1,854</u>
<b>OTHER INCOME (EXPENSE), NET</b> .....	<u>(1)</u>	<u>55</u>	<u>12</u>	<u>157</u>
Income before interest charges .....	<u>643</u>	<u>1,032</u>	<u>2,192</u>	<u>2,011</u>
<b>INTEREST CHARGES</b>				
Interest expense .....	911	1,017	2,014	2,084
Allowance for funds used during construction .....	(17)	(29)	(55)	(81)
Net interest charges .....	<u>894</u>	<u>988</u>	<u>1,959</u>	<u>2,003</u>
Net (loss) income before cumulative effect of change in accounting principles .....	(251)	44	233	8
Cumulative effect of change in accounting principles .....	217	—	—	—
<b>NET INCOME (LOSS)</b> .....	<u>(34)</u>	<u>44</u>	<u>233</u>	<u>8</u>
Return on appropriation investment .....	<u>(19)</u>	<u>(20)</u>	<u>(40)</u>	<u>(41)</u>
Increase (decrease) in retained earnings .....	(53)	24	193	(33)
Retained earnings reinvested at beginning of period .....	<u>3,580</u>	<u>3,387</u>	<u>3,387</u>	<u>3,420</u>
Retained earnings reinvested at end of period .....	<u>\$3,527</u>	<u>\$3,411</u>	<u>\$3,580</u>	<u>\$3,387</u>

(1) The six months ended March 31, 1998 has been reclassified to conform to fiscal 1999 presentation.

**TENNESSEE VALLEY AUTHORITY  
POWER PROGRAM**

**CONDENSED STATEMENTS OF CASH FLOWS  
For the Six Months Ended March 31, 1999 and 1998  
and for the Years Ended September 30, 1998 and 1997**

	Six Months Ended March 31,		Years Ended September 30,	
	1999	1998	1998	1997
	(Millions)			
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>				
Net income (loss) .....	\$ (34)	\$ 44	\$ 233	\$ 8
Items not requiring cash .....	679	646	1,297	1,030
Other, net .....	(66)	(132)	(136)	28
Net cash provided by operating activities .....	<u>579</u>	<u>558</u>	<u>1,394</u>	<u>1,066</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>				
Construction expenditures .....	(350)	(240)	(637)	(722)
Allowance for funds used during construction .....	17	29	55	81
Other, net .....	(132)	(35)	(160)	61
Net cash used in investing activities .....	<u>(465)</u>	<u>(246)</u>	<u>(742)</u>	<u>(580)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>				
Borrowings, net .....	(442)	(163)	(699)	(352)
Other .....	(54)	195	139	(73)
Net cash provided by (used in) financing activities .....	<u>(496)</u>	<u>32</u>	<u>(560)</u>	<u>(425)</u>
Net change in cash and cash equivalents .....	<u><u>\$ (382)</u></u>	<u><u>\$ 344</u></u>	<u><u>\$ 92</u></u>	<u><u>\$ 61</u></u>

**Results of Operations for the Six Months Ended March 31, 1999**

TVA's net loss for the six months ended March 31, 1999 amounted to \$34 million, a decline of \$78 million from the net income of \$44 million for the same period last year. Fiscal year-to-date operating revenues decreased \$79 million from \$3,121 million in 1998 to \$3,042 million in 1999. This year-to-date decline is attributable to the weather-related reduction in kilowatt-hour sales of 6 percent from 80 billion kilowatt-hours in 1998 to 75 billion kilowatt-hours in 1999.

Operating expenses for the six months ended March 31, 1999 were \$2,398 million compared with \$2,144 million for the same period last year. The \$254 million increase was primarily due to a \$217 million charge for the acceleration of the amortization of regulatory assets in December 1998 (see below).

Net interest expense declined \$94 million for the six months ended March 31, 1999, as compared with the same period of 1998. This reduction reflects the interest savings associated with refi-

nancing \$3.2 billion of debt formerly held by the Federal Financing Bank and other financing transactions.

TVA changed its accounting policy regarding the method of determining the market-related value of pension assets — resulting in a one-time gain of approximately \$217 million — which is presented on the Statement of Income under the caption “Cumulative effect of change in accounting principles”. Also effective October 1, 1998, the TVA Board authorized a change in the amortization policy for regulatory assets to provide for adjusting periodic amortization amounts as necessary to achieve annual earnings levels set by the Board of Directors in connection with the rate review. In accordance with the revised policy, TVA accelerated amortization of certain regulatory assets by a corresponding \$217 million during December 1998.

**Liquidity and Capital Resources**

Net cash provided by operations increased \$21 million from \$558 million to \$579 million for the six months ended March 31, 1998 and 1999, re-

spectively. For the reporting period, the net loss increased by \$78 million, and items not requiring cash increased by \$33 million. Working capital requirements, however, declined by \$66 million primarily as a result of a reduction in accounts receivable related to mild weather.

Net cash used in investing activities increased \$219 million from \$246 million for the six-month period ended March 31, 1998 to \$465 million for the corresponding period in fiscal 1999. Cash used for construction expenditures increased \$110 million for the reporting period, primarily due to construc-

tion beginning on new natural gas combustion turbines for peaking capacity. In addition, cash outflows for other investing increased \$97 million primarily due to timing of nuclear enrichment and fabrication services.

Cash flows used in financing activities amounted to \$496 million for the six-month period ended March 31, 1999. During the same period last year, cash flows from net borrowings were used to increase cash in anticipation of debt refinancings, while in the current year, cash was used to reduce debt by approximately \$442 million.

## Other Matters

**EPA Enforcement Initiative.** The Environmental Protection Agency (“EPA”) is investigating whether coal-fired utilities in the eastern U.S., including TVA, may have modified their coal-fired power plants without complying with EPA’s new source program requirements. EPA recently requested that TVA provide information regarding modifications to TVA’s coal-fired plants during the period from 1978 to 1998. TVA is gathering the requested information. The outcome of this investigation is uncertain, but could result in the earlier implementation of emission control measures similar to those discussed in “Environmental Matters” — “Air Pollution” in the current Information Statement.

**Electric Industry Restructuring Proposal.** On April 15, 1999, the Clinton Administration announced its legislative proposal for restructuring of the electric utility industry. The Administration’s proposal includes provisions regarding TVA’s power business that are largely based on negotiations among TVA, distributors of TVA power, the Department of Energy and many other TVA customers and stakeholders. Craven Crowell, Chairman of TVA’s Board of Directors (the “Board”), has issued a statement saying: “We believe this legislation treats Tennessee Valley residents fairly, and we are prepared to support it”. You should read the following description together with the “Rates, Customers and Market” and “Competition” sections beginning at page 7 of the attached current Information Statement.

The proposal’s key features affecting TVA include (i) the repeal, as of January 1, 2003, of statutory restrictions on TVA’s ability to sell excess power at wholesale outside of its current service area (commonly referred to as the “fence”) and statutory restrictions on TVA competitors’ ability to require TVA to transmit their power for sale within the TVA service area (commonly referred to as “anti-cherry picking provisions”); (ii) within one year of enactment, renegotiation of TVA’s power contracts with the distributors of TVA power, as to the remaining term of the contract, length of termination notice, amount of power a distributor can purchase from a supplier other than TVA beginning January 1, 2003, and recovery of stranded investments; (iii) authorization of the Federal Energy Regulatory Commission (“FERC”) to make the final determination of any unresolved issues

under (ii); (iv) restriction of future TVA retail sales to those customers TVA is directly serving on the date of enactment of the legislation and to those in the service areas of distributors of TVA power that either agree to such sales or that take 50 percent or less of their power from TVA; (v) FERC regulation of TVA’s recovery of stranded costs from its directly-served customers and distributors in accordance with statutory guidelines, with no recovery after September 30, 2007, except by agreement; (vi) FERC regulation of TVA transmission system service, beginning January 1, 2003, on generally the same basis as investor-owned utilities are regulated; (vii) application of Federal antitrust laws to TVA’s activities effective January 1, 2003, except with respect to civil damages and attorneys’ fees; (viii) elimination of TVA’s regulation of rates, terms and conditions of distributors’ retail electric service; and (ix) retention of the Board’s authority to set and adjust TVA wholesale power rates.

Enactment of this proposal would, among other things, permit TVA to sell excess wholesale power outside its current service area at rates set by the Board, providing TVA with increased opportunities for sales of TVA wholesale power; possibly result in a reduction in the term of TVA’s power contracts with the distributors of its power and in the amount of power the distributors must purchase from TVA under those contracts; and possibly result in a loss of customers due to repeal of the anti-cherry picking provisions.

**Year 2000 Readiness Update.** As of March 1, 1999, TVA had closed nearly 87 percent of all mission-critical items being tracked in its Year 2000 program. In particular, TVA’s remediation, testing and implementation activities with respect to the following areas were complete to the following extent as of March 1, 1999:

<u>Focus Area</u>	<u>Percentage Complete</u>
Computer Hardware and Equipment . .	100
Application Software . . . . .	38
Systems Software . . . . .	100
Facilities . . . . .	99
Telecommunications . . . . .	99

TVA expects to complete the majority of its remediation, testing and implementation activities relating to mission-critical items for each of the areas listed above by the end of June 1999.

As of March 1, 1999, TVA's remediation, testing and implementation activities for embedded controls critical to each of the following areas of operation were complete to the following extent and are expected to be completed on the following dates:

<u>Area of Operation</u>	<u>Percentage Complete</u>	<u>Expected Date of Final Completion</u>
Nuclear . . . . .	72	July 1999
Fossil . . . . .	43	November 1999
Hydro . . . . .	100	Completed
Transmission and Power Supply . . .	70	May 1999

The projected cost of TVA's Year 2000 remediation efforts is now \$39.8 million. As of March 1, 1999, TVA had expended approximately \$23 million of this amount. See "Power System" — "Year 2000 Readiness" in the current Information Statement.

## DESCRIPTION OF BONDS

### General

TVA will issue the Bonds under authority of the Tennessee Valley Authority Act of 1933, as amended (the "Act"), and pursuant to the Basic Tennessee Valley Authority Power Bond Resolution adopted on October 6, 1960, as amended on September 28, 1976, October 17, 1989 and March 25, 1992 (the "Basic Resolution"), and the Supplemental Resolution authorizing the Bonds adopted as of February 17, 1999 (the "Supplemental Resolution" and together with the Basic Resolution, the "Resolutions"). The Secretary of the Treasury has approved the time of issuance of and the maximum rate of interest to be borne by the Bonds, in compliance with Section 15d(c) of the Act. The Bonds are obligations of TVA only, payable solely from TVA's Net Power Proceeds. The Bonds are not obligations of or guaranteed by the United States of America.

TVA will issue the Bonds through the book-entry system of DTC. As long as the Bonds remain in book-entry form, DTC, its nominee, a successor securities depository or its nominee will be the sole registered holder (the "Holder") of the Bonds for all purposes of the Resolutions. Each person owning a beneficial interest in the Bonds (a "Beneficial Owner") must rely on the procedures of DTC. If you are a Beneficial Owner but do not hold your

interest in the Bonds directly through DTC, you must rely on the procedures of the participant in DTC through which you hold your interest in order to exercise any rights of a Holder under the Resolutions. See "Book-Entry System" below.

The Act authorizes TVA to issue and sell bonds, notes and other evidences of indebtedness (collectively, "Evidences of Indebtedness") to assist in financing its power program and to refund such Evidences of Indebtedness. Section 2.2 of the Basic Resolution designates certain Evidences of Indebtedness as Tennessee Valley Authority Power Bonds ("Power Bonds"). The aggregate amount of Evidences of Indebtedness outstanding at one time cannot exceed \$30 billion. As of March 31, 1999, TVA had approximately U.S.\$24.9 billion, DM 1.5 billion (issued in September 1996) and £200 million (issued in December 1998) of Evidences of Indebtedness outstanding. When TVA issued its Deutsche Mark and British pound sterling Evidences of Indebtedness, it entered into currency swap agreements to hedge against fluctuation in such currencies. For information regarding Power Bonds and the Basic Resolution, see "The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness" — "Issuance of Additional Bonds and Other Evidences of Indebtedness" in the current Information Statement.

The summaries of certain provisions of the Act and the Resolutions are not complete and are entirely qualified by reference to the complete Act and Resolutions. You may obtain complete copies of these documents by writing to **Tennessee Valley Authority, 400 West Summit Hill Drive, Knoxville, Tennessee 37902, Attention: Vice President and Treasurer, or by calling (423) 632-3366.**

The Bonds will be Power Bonds. TVA will pay all interest and principal on the Bonds solely from its Net Power Proceeds. "Net Power Proceeds" are the remainder of TVA's gross power revenues from its power program,

*after deducting*

- the costs of operating, maintaining and administering its power properties (including multiple-purpose properties in the proportion that multiple-purpose costs are allocated to power) and
- payments to states and counties in lieu of taxes,

*but before deducting*

- depreciation accruals or other charges representing the amortization of capital expenditures,

*plus*

- the net proceeds of the sale or other disposition of any interest in TVA's power properties that constitute an operating unit or system.

In accordance with Public Law No. 105-62, TVA is required, beginning October 1, 1998, in the absence of sufficient appropriations, to fund nonpower programs that constitute "essential stewardship activities" with revenues derived from one or more of various sources, including power revenues, notwithstanding provisions of the Act and Resolutions to the contrary. See the discussion of Public Law No. 105-62 in "The Basic Resolution; Power Bonds, Discounts Notes and Other Indebtedness" — "Recent Legislation" in the current Information Statement. Under the Supplemental Resolution, actions taken pursuant to Public Law No. 105-62 shall not be considered an event of default or breach under the Resolutions.

The Bonds will rank equally with all other Power Bonds in application of Net Power Proceeds. Power Bonds currently rank *senior to* other Evidences of Indebtedness as to *principal*, and *senior to or on parity with* other Evidences of Indebtedness as to *interest*. It is possible at some time prior to the maturity of the Bonds that Evidences of Indebtedness other than Power Bonds may also rank on parity with Bonds as to principal. See "The Basic Resolution; Power Bonds, Discount Notes, and Other Indebtedness" — "Amendments to the Basic Resolution to Become Effective in the Future" in the current Information Statement. For a further discussion of the application of the Net Power Proceeds, see "Certain Provisions of the Tennessee Valley Authority Act" and "The Basic Resolution; Power Bonds, Discount Notes, and Other Indebtedness" — "Application of Net Power Proceeds" in the current Information Statement.

Except as provided under the Act, the Basic Resolution and the Supplemental Resolution, there is no limit on other indebtedness or securities that TVA may issue and no financial or similar restrictions on TVA. TVA issues Discount Notes pursuant to Section 15d of the Act and in accordance with Section 2.5 of the Basic Resolution. TVA may also issue other indebtedness in addition to Power Bonds

and Discount Notes. TVA issues other indebtedness, such as Quarterly Income Debt Securities, pursuant to Section 15d of the Act and under appropriate authorizing resolutions. See "The Basic Resolution; Power Bonds, Discount Notes, and Other Indebtedness" in the current Information Statement.

### **Possible Future Issuances**

TVA may issue additional Bonds in one or more future installments. TVA may do so without consent of the Holder or Beneficial Owners. Additional Bonds issued must be identical in all respects to the Bonds originally issued, except for any appropriate related changes, including changes in the issue date, issue price and interest commencement date.

### **Payment of Principal and Interest**

The Bonds will consist of \$450,000,000 aggregate principal amount of Tennessee Valley Authority Power Bonds 1999 Series A Due May 1, 2029 (Putable Automatic Rate Reset Securities). TVA will issue the Bonds in \$25 denominations in book-entry form only through DTC, as described below in "Book-Entry System". TVA will pay interest quarterly in arrears on February 1, May 1, August 1 and November 1 (each an "Interest Payment Date") beginning August 1, 1999. Interest payments will include any interest accrued from and including May 6, 1999, or the preceding Interest Payment Date, to but excluding the relevant Interest Payment Date. Interest will be computed as described in "Interest Computation" below. TVA will repay the principal amount of all outstanding Bonds, together with accrued but unpaid interest, on May 1, 2029 (the "Maturity Date"). TVA will make principal and interest payments on the Bonds on the applicable payment dates to the Holder as of the close of business on the Business Day (as defined herein) preceding the payment dates. As long as the Bonds are in book-entry form, the Holder will be DTC, its nominee, a successor securities depository or its nominee. **Direct participants in DTC's book-entry system and other financial intermediaries holding Bonds on behalf of Beneficial Owners are responsible for remitting payments to their customers.**

If any Interest Payment Date or the Maturity Date is not a Business Day, TVA shall make payment on the next succeeding Business Day, and



such payment shall have the same force and effect as if made on such Interest Payment Date or Maturity Date. A “Business Day” is any day except a Saturday, Sunday or day on which banking institutions in New York City are authorized or required by law or executive order to be closed.

### Interest Computation

The rate at which the Bonds bear interest (the “Coupon Rate”) will be computed based on a 360-day year of twelve 30-day months using the following rules:

*Initial Coupon Rate.* Initially, the Bonds shall bear interest at an annual Coupon Rate of 6.50% from and including May 6, 1999 to but excluding May 1, 2004.

*Reset of Coupon Rate.* The Wednesday following the last Friday in March of 2004 and each such Wednesday annually thereafter (or the next succeeding Business Day, if any such date is not a Business Day) shall be a “Calculation Date”. If the sum of the CMT (as defined below) for the week ending the last Friday in March plus 0.84% is lower than the Coupon Rate of the Bonds on such Calculation Date, then the Coupon Rate will be reset to the lower rate equal to such sum. The Bonds shall begin to bear interest at this new Coupon Rate on the May 1 following such Calculation Date.

The “CMT” is the rate published in “Statistical Release H.15(519), ‘Selected Interest Rates’”, or any successor publication, published by the Board of Governors of the Federal Reserve System under the heading “U.S. government securities — Treasury constant maturities — 30-year”.

The Bonds shall continue to bear interest at this new Coupon Rate until the next reset, if any. For a summary of some of the risks associated with Coupon Rate resets, see “Risk Factors”. TVA will send notice of any reset by the close of business on the first Business Day after the Calculation Date (the “Reset Notification Date”). TVA will send all notices about the Bonds, including notices regarding reset of the Coupon Rate, only to DTC or a successor depository. TVA has been advised that such notices will be given by DTC to its Direct Participants (as defined below), by Direct Participants to Indirect Participants (as defined below) and by Direct Participants and Indirect Participants to Beneficial Owners as described under “Book-

Entry System” below. **Beneficial Owners of Bonds that are not also Direct Participants are responsible for making arrangements with their Financial Institutions to obtain all notices, including reset notices.**

*CMT Contingencies.* If a previously reported CMT figure for a Calculation Date is revised after such date, this shall not affect the Coupon Rate. If the CMT is discontinued or materially altered while the Bonds are outstanding, TVA may, in its sole discretion, substitute an alternative index that TVA believes most closely resembles the CMT before it was discontinued or altered. If a substitution is necessary, TVA shall use the alternative index in place of the CMT for future Coupon Rate reset calculations. TVA may at any time substitute a different index for the alternative index if TVA determines, in its sole discretion, that the different index more closely resembles the CMT before it was discontinued or altered.

### Redemption

TVA may not redeem the Bonds prior to maturity.

### Put Option

If the Coupon Rate on the Bonds is reset, you can put (return) any of your Bonds to TVA for repayment. You will receive \$25 for each Bond you put to TVA. TVA will pay separately any accrued interest due on a returned Bond on the appropriate Interest Payment Date.

To exercise this put (repayment) option, you are responsible for having your Financial Institution (1) notify TVA and (2) have the Bond returned, as described below.

*Notification of Repayment Election.* If you want to put a Bond to TVA, you must inform your broker or other financial institution through which you beneficially hold your Bond (your “Financial Institution”) and **authorize your Financial Institution** to submit notice of exercise of the put option on your behalf. Your Financial Institution must then complete the Summary Election Form and the Option to Elect Repayment Form, substantially in the form — and in accordance with the instructions — contained in this Offering Circular. (See pages beginning at C-29.) TVA will provide copies of these forms and instructions to you or your Financial Institution upon request. The Option to

Elect Repayment Form requires your Financial Institution to make certain representations and to agree to certain terms, including the indemnification of TVA against certain losses and costs. If your Financial Institution will not make these representations and agree to these terms, TVA shall not be obligated to honor your request to put the Bond. See “Risk Factors”. **It is your responsibility to determine from your Financial Institution whether it will make the representations and agree to the terms in the Option to Elect Repayment Form and instructions.** After completion of the Summary Election Form and the Option to Elect Repayment Form, your Financial Institution must submit these forms to TVA. TVA must **receive** both forms at the office specified in the instructions *no earlier than* the relevant Reset Notification Date and *no later than* April 21 (or the prior Business Day, if such date is not a Business Day) of the year of such Reset Notification Date. **It is your responsibility to determine from your Financial Institution the amount of advance notice it needs from you to comply with the notice provisions described above.** A properly submitted notice of exercise of the put option by your Financial Institution shall be *irrevocable*. After receiving such notice, TVA will assign a number (an “Election Number”) to the notice and provide the Election Number to your Financial Institution.

**Return of Bond.** After TVA has provided the Election Number to your Financial Institution, as described above, your Financial Institution must arrange for your Bonds to be returned to TVA. The Option to Elect Repayment Form and instructions direct your Financial Institution to make necessary arrangements to return your Bonds. If you elect to put your Bonds to TVA, your Financial Institution must return your Bonds to TVA by the close of business on May 1 (or the next succeeding Business Day, if such date is not a Business Day) following the relevant Reset Notification Date (the “Return Date”). Your Financial Institution must arrange for the delivery of your Bonds to TVA through DTC’s book-entry system. If there is a delay in repayment of the Bonds due to the fact that TVA cannot verify the receipt of Bonds by close of business on the Return Date, TVA shall not pay interest on such Bonds on or after the requested Return Date. TVA will make payment equal to the appropriate principal amount of your Bonds by wire transfer to the account specified by the Holder. If a delivery

of a Bond for repayment is not accompanied with the correct Election Number, the Bond may be returned and be ineligible for repayment on the requested Return Date.

## Repayment

The Bonds will be repaid at par (\$25) on the Maturity Date or on the date you properly put your Bonds to TVA. Interest will be paid separately as described in “Payment of Principal and Interest”.

## Notices

TVA will send all notices about the Bonds and reset of the Coupon Rate *only* to DTC or a successor depository. TVA has been advised that such notices will be given by DTC to its Direct Participants, by Direct Participants to Indirect Participants and by Direct Participants and Indirect Participants to Beneficial Owners, as described in “Book-Entry System” below. You are responsible for making arrangements with your Financial Institution to obtain all notices about the Bonds.

## Book-Entry System

DTC will act as securities depository for the Bonds. The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC’s partnership nominee). One or more fully-registered global certificates (the “Global Securities”) will be issued for the Bonds, in the aggregate principal amount of the Bonds, and will be deposited with DTC.

DTC is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds securities that its participants deposit with DTC. DTC also facilitates the settlement among its participants of securities transactions, such as transfers and pledges, in deposited securities through electronic computerized book-entry changes in participants’ accounts, thereby eliminating the need for physical movement of securities certificates. Direct partici-

pants in DTC include securities brokers and dealers (including certain of the Underwriters), banks, trust companies, clearing corporations, and certain other organizations (“Direct Participants”). DTC is owned by a number of its Direct Participants and by the New York Stock Exchange, Inc., the American Stock Exchange, Inc., and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as securities brokers and dealers, banks and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). The rules applicable to DTC and its Direct Participants and Indirect Participants are on file with the Securities and Exchange Commission.

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC’s records. The ownership interest of each Beneficial Owner is then to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Bonds, except in the event that use of the book-entry system for the Bonds is discontinued. See “Discontinuance of Book-Entry System” below.

To facilitate subsequent transfers, the Global Securities deposited by Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co. The deposit of the Global Securities with DTC and their registration in the name of Cede & Co. effect no change in beneficial ownership of the Bonds. DTC has no knowledge of the actual Beneficial Owners of the Bonds. DTC’s records reflect only the identity of the Direct Participants to whose accounts Bonds are credited, which may or may not be the Beneficial Owners. Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements in effect.

Neither DTC nor Cede & Co. will consent or vote with respect to Bonds. Under its usual procedures, DTC mails an Omnibus Proxy to an issuer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.’s consenting or voting rights to those Direct Participants to whose accounts the securities are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the Bonds will be made to Cede & Co., as nominee of DTC. DTC’s practice is to credit Direct Participants’ accounts upon DTC’s receipts of funds and corresponding detail information from an issuer in accordance with Direct Participants’ respective holdings shown on DTC’s records. Payments by Direct and Indirect Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in “street name”. These payments will be the responsibility of Direct Participants and Indirect Participants only and not of DTC or TVA, subject to any statutory or regulatory requirements in effect. Payment of principal and interest to Cede & Co. is the responsibility of TVA. Disbursement of these payments to Direct Participants shall be the responsibility of DTC. Disbursement of these payments to the Beneficial Owners shall be the responsibility of Direct Participants and Indirect Participants.

DTC may discontinue acting as the securities depository at any time by giving reasonable notice to TVA. TVA may discontinue use of DTC’s book-entry system at any time. Under these circumstances, TVA may select a substitute depository to act as securities depository for the Bonds or may deliver certificates as described under “Discontinuance of Book-Entry System” below.

DTC management is aware that some computer applications, systems, and the like for processing data (“Systems”) that are dependent upon calendar dates, including dates before, on and after January 1, 2000, may encounter “Year 2000

problems”. DTC has informed its DTC Direct Participants and other members of the financial community (the “Industry”) that it has developed and is implementing a program so that its Systems, as the same relate to the timely payment of distributions (including principal and income payments) to securityholders, book-entry deliveries, and settlement of trades within DTC (“DTC Services”), continue to function appropriately. This program includes a technical assessment and a remediation plan, each of which is complete. Additionally, DTC’s plan includes a testing phase, which is expected to be completed within appropriate time frames.

However, DTC’s ability to perform properly its services is also dependent upon other parties, including but not limited to issuers and their agents, as well as third party vendors from whom DTC licenses software and hardware, and third party vendors on whom DTC relies for information or the provision of services, including telecommunication and electrical utility service providers, among others. DTC has informed the Industry that it is contacting (and will continue to contact) third party vendors from whom DTC acquires services to: (i) impress upon them the importance of such services being Year 2000 compliant; and (ii) determine the extent of their efforts for Year 2000 remediation (and, as appropriate, testing) of their services. In addition, DTC is in the process of developing such contingency plans as it deems appropriate.

According to DTC, the foregoing information with respect to DTC has been provided to the Industry for informational purposes only and is not intended to serve as a representation, warranty, or contract modification of any kind.

#### **Discontinuance of Book-Entry System**

If use of the book-entry system is discontinued and no successor depository is selected by TVA, the provisions of this section shall apply.

DTC (or a successor depository) shall instruct TVA in whose names the Bonds should be registered, and TVA will register the Bonds accordingly. Registration instructions are expected to be based on information that Direct Participants provide DTC regarding beneficial interests in the Global Securities.

After the initial registration, registration of transfer or exchange of certificates representing the Bonds may be made at the office of TVA or a securities registrar appointed by TVA (a “Registrar”) in the Borough of Manhattan, City of New York, New York. Neither TVA nor any Registrar will impose any service charge for registration of transfer or exchange of certificates representing Bonds. TVA may, however, require payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in connection with the register of transfer or exchange of Bonds.

TVA will make payment of principal of and interest on the Bonds at the office or agency of TVA maintained for this purpose in the Borough of Manhattan, City of New York. TVA may, however, at its option, pay interest by check mailed to the address of each Beneficial Owner that appears in the register maintained by TVA or a Registrar or by electronically transferring funds to the Beneficial Owner.

TVA will establish appropriate procedures for Beneficial Owners to return their Bonds to TVA upon Coupon Rate resets. TVA will notify Beneficial Owners who appear in the register maintained by TVA or a Registrar of these procedures at the time the book-entry system is discontinued. TVA will give all notices about the Bonds and the reset of the Coupon Rate in accordance with the procedures of any stock exchange on which the Bonds are listed.

#### **Governing Law**

The Bonds shall be governed by and construed in accordance with the laws of the State of New York, to the extent such laws are not inconsistent with federal law.

#### **Listing**

TVA has applied to list the Bonds on the New York Stock Exchange. See “Underwriters”.

#### **Rating**

The Bonds have been rated Aaa by Moody’s Investors Service and AAA by Standard & Poor’s.

#### **LEGALITY OF INVESTMENT**

The laws of some jurisdictions limit the type and amount of securities that certain institutional



investors may acquire. TVA advises each entity or person to consult its own counsel respecting the legality of investment in the Bonds. The Bonds could be subject to certain restrictions or requirements as to legality of investment that do not apply to Power Bonds with fixed rates of interest. Generally, the following describes the legality of investment in Power Bonds *with fixed rates of interest*:

- Power Bonds are lawful investments and are acceptable as security for all fiduciary, trust and public funds, the investment or deposit of which shall be under the authority or control of any officer or agency of the United States. 16 U.S.C. § 831n-4(d).
- National banks may deal in, underwrite and purchase Power Bonds for their own accounts in an amount not to exceed 10% of unimpaired capital and surplus. 12 U.S.C. § 24, seventh paragraph.
- Federal Reserve Banks may accept Power Bonds as eligible collateral for advances to member banks. 12 U.S.C. § 347 and 12 C.F.R. § 201.108(b)(13).
- Federal savings associations and federal savings banks may, to the extent specified in applicable regulations, invest in Power Bonds without regard to limitations generally applicable to investments. 12 U.S.C. § 1464(c)(1)(F).
- Power Bonds are eligible as collateral for advances by Federal Home Loan Banks to members for which Power Bonds are legal investments. 12 U.S.C. § 1430(a) and 12 C.F.R. § 935.9(a)(2).
- Federal credit unions may purchase Power Bonds. 12 U.S.C. § 1757(7)(E).
- Power Bonds are “obligations of a corporation which is an instrumentality of the United States” within the meaning of Section 7701(a)(19)(C)(ii) of the Internal Revenue Code for purposes of the 60% of assets limitation applicable to building and loan associations.

## TAX MATTERS

The following summary of certain federal income and estate tax and certain limited state and local tax consequences (where specifically noted) of the purchase, ownership, and disposition of the Bonds has been prepared by Orrick, Herrington & Sutcliffe LLP, as special tax counsel to TVA (“Tax Counsel”), and is based upon laws, regula-

tions, rulings and decisions, which are subject to change at any time, possibly with retroactive effect. The discussion does not address all aspects of federal income and estate taxation that may be relevant to a particular investor in light of its personal investment circumstances or to certain types of investors subject to special treatment under the federal income tax laws (for example, brokers, security dealers, traders in securities that elect to mark to market, banks, life insurance companies, tax-exempt organizations and, with limited exceptions, foreign investors), and generally does not address state and local taxation. Further, the discussion is limited to persons who will hold the Bonds as capital assets and does not deal with the federal income tax consequences applicable to persons who will hold the Bonds in the ordinary course or as an integral part of their trade or business, or as part of a hedging, straddle, integrated, or conversion transaction or persons whose functional currency is not the U.S. dollar. Furthermore, it does not address alternative minimum tax consequences or the indirect effects on the holders of equity interests in a beneficial owner of a Bond. Each prospective owner of a Bond is urged to consult with its own tax advisor with respect to the federal, state and local tax consequences associated with the purchase, ownership, and disposition of a Bond, as well as the tax consequences arising under the laws of any other taxing jurisdiction, and may not construe the following discussion as legal advice.

For purposes of this section, “U.S. Person” means a citizen or resident of the United States, a corporation or (except as may be provided in Treasury Regulations) partnership organized in or under the laws of the United States or any political subdivision thereof, an estate the income of which is includible in gross income for United States tax purposes regardless of its source or a trust if a United States court is able to exercise primary supervision over administration of the trust and one or more U.S. Persons have authority to control all substantial decisions of the trust. The term “U.S. beneficial owner” means a U.S. Person that is a beneficial owner of a Bond.

### U.S. Beneficial Owners

A U.S. beneficial owner is subject to federal income taxation on income on a Bond. The Act, however, provides that bonds issued by TVA are “exempt both as to principal and interest from all taxation now or hereafter imposed by any state or

local taxing authority except estate, inheritance and gift taxes". This exemption might not extend to franchise or other non-property taxes in lieu thereof imposed on corporations or to gain or loss realized upon the sale or exchange of a Bond, notwithstanding that such gain might in some cases be treated as interest income for federal income tax purposes.

The rules relating to the accrual of original issue discount ("OID") are exceedingly complex and their application to debt instruments similar to the Bonds is not certain. Nevertheless, Tax Counsel believes that it is reasonable for TVA and the beneficial owners of the Bonds to treat the Bonds as variable rate debt instruments for purposes of the OID rules. Tax Counsel's opinion is premised on the assumptions that it is reasonably expected that the interest on the Bonds will not be significantly front-loaded, that the issue price of the Bonds will not be significantly less than the price that would have obtained had no ceiling limitation applied to the interest rate reset feature of the Bonds (that is, if the rate on the Bonds was adjustable upwards as well as downwards) and that the Bonds are properly treated under the OID rules as being "unconditionally" puttable on the first date on which the Coupon Rate may be reset. It is possible that the Internal Revenue Service ("IRS") might disagree with the characterization of the Bonds as variable rate debt instruments, and assert that the Bonds constitute contingent payment debt instruments. If the IRS were successful in this assertion, all beneficial owners of Bonds would, *inter alia*, be required to account for interest on the Bonds under the accrual method of accounting (computed pursuant to special rules applicable to contingent payment debt instruments), any gain realized on a disposition of a Bond would be characterized as ordinary income and special rules would apply relating to the accrual of market discount and acquisition premium. As indicated above (and based on the assumptions previously stated), Tax Counsel believes that it is reasonable to characterize the Bonds as variable rate debt instruments, and TVA and, by purchasing the Bonds, each beneficial owner of the Bonds agree they will treat the Bonds as such. Each beneficial owner of a Bond is urged to consult its own tax advisor with respect to this issue. The remainder of this section is premised on the assumption that the Bonds are properly characterized as variable rate debt instruments under the OID rules.

Interest on a Bond will be taxable to a U.S. beneficial owner at the time that it is received or accrued, depending upon the U.S. beneficial owner's method of accounting for federal income tax purposes. Accordingly, similar to other Power Bonds issued by TVA without OID, a cash-method U.S. beneficial owner of the Bonds will not be required to include interest on the Bonds in income prior to the U.S. beneficial owner's receipt of such interest. There is no special exemption for a Bond from federal income, estate and gift tax.

Upon a sale or exchange of a Bond, a U.S. beneficial owner generally will recognize capital gain or loss equal to the difference between the amount realized on the sale or exchange (not including any amounts attributable to accrued and unpaid interest) and the U.S. beneficial owner's adjusted basis for the Bond for federal income tax purposes.

If a U.S. beneficial owner purchases a Bond for less than its stated redemption price at maturity, in general, that difference will be market discount (unless the discount is less than  $\frac{1}{4}$  of 1% of the stated redemption price at maturity of the Bond multiplied by the number of complete years remaining to maturity). In general, under the market discount rules, unless the U.S. beneficial owner elects to include market discount in income currently, any gain on a disposition of a market discount Bond will be ordinary income to the extent of accrued market discount, and deductions for some or all of the interest on any indebtedness incurred or continued to purchase or carry the Bond may be deferred until the disposition of the Bond. Any election to include market discount in income currently generally applies to all debt instruments acquired by the electing U.S. beneficial owner during or after the first taxable year to which the election applies and is irrevocable without the consent of the IRS. A U.S. beneficial owner should consult a tax advisor before making the election.

A U.S. beneficial owner who purchases a Bond for an amount greater than the amount payable at maturity of the Bond may elect to amortize the bond premium. In the case of a U.S. beneficial owner that makes an election to amortize bond premium or has previously made an election that remains in effect, amortizable bond premium on the Bond generally will be treated as a reduction of the interest income on a Bond on a constant yield basis (except to the extent regulations may provide



otherwise) over the term of the Bond. The basis of a debt obligation purchased at a premium is reduced by the amount of amortized bond premium. An election to amortize bond premium generally applies to all debt instruments (other than tax-exempt obligations) held by the electing U.S. beneficial owner on the first day of the first taxable year to which the election applies or thereafter acquired by such owner, and is irrevocable without consent of the IRS. A U.S. beneficial owner should consult a tax advisor before making the election.

A U.S. beneficial owner may elect to include in gross income all interest that accrues on a debt instrument using the constant yield method. For purposes of this election, interest includes stated interest, OID, market discount, de minimis market discount and unstated interest, as adjusted by any amortizable bond premium or acquisition premium. If this election is made with respect to a debt instrument with amortizable bond premium, the electing U.S. beneficial owner will be deemed to have elected to apply amortizable bond premium against interest with respect to all debt instruments with amortizable bond premium (other than debt instruments the interest on which is excludible from gross income) which are held by the electing U.S. beneficial owner as of the beginning of the taxable year in which the debt instrument with respect to which the election is made is acquired or which are thereafter acquired by the U.S. beneficial owner. The deemed election with respect to amortizable bond premium may not be revoked without the consent of the IRS. If this election is made with respect to a debt instrument with market discount, the electing U.S. beneficial owner will be deemed to have elected to include market discount in income currently (as discussed above) with respect to all debt instruments acquired by the electing U.S. beneficial owner during or after the first taxable year to which the election applies, which election may not be revoked without the consent of the IRS.

### **Non-U.S. Beneficial Owners**

Generally, a beneficial owner that is not a U.S. Person and that had no connection with the United States other than holding the Bond (a “non-U.S. beneficial owner”) will not be subject to federal withholding tax on interest on a Bond. To qualify for the exemption from withholding, the last U.S. Person in the chain of payment prior to payment to a non-U.S. beneficial owner (the “Withholding

Agent”) must have received in the year in which such a payment occurs, or in either of the two preceding years, a statement that (i) is signed by the beneficial owner under penalties of perjury, (ii) certifies that such owner is not a U.S. beneficial owner and (iii) provides the name and address of the beneficial owner. The statement may be made on an IRS Form W-8 BEN or IRS Form W-8 EXP (collectively, “Form W-8”), as applicable, or substantially similar substitute form, and the beneficial owner must inform the Withholding Agent of any change in the information on the statement within 30 days of such change. If a Bond is held through a securities clearing organization or certain other financial institutions, the organization or institution may provide a signed statement to the Withholding Agent. However, in such case, the signed statement must be accompanied by a copy of the Form W-8 or substitute form provided by the beneficial owner to the organization or institution holding the Bond on behalf of the beneficial owner.

Recently issued regulations would provide alternative methods for satisfying the certification requirements described above (the “New Regulations”). The New Regulations also would require, in the case of Bonds held by a foreign partnership, that (i) the certification described above be provided by the partners rather than by the foreign partnership and (ii) the partnership provide certain information, including a taxpayer identification number. A look-through rule would apply in the case of tiered partnerships. The New Regulations are generally effective for payments made after 1999. There can be no assurance that the New Regulations will not be amended prior to the date they first become effective.

Generally, any amount which constitutes capital gain to a non-U.S. beneficial owner upon retirement or disposition of a Bond will not be subject to federal income taxation in respect of such amount. Certain exceptions may be applicable and individual non-U.S. beneficial owners are particularly urged to consult a tax advisor. Generally, the Bonds will not be includible in the federal estate of a non-U.S. beneficial owner.

### **Backup Withholding**

Backup withholding of federal income tax at a rate of 31% may apply to payments made in respect of the Bonds to beneficial owners who are not exempt recipients and who fail to provide certain

identifying information (such as the beneficial owner's taxpayer identification number) in the manner required. Generally, individuals are not exempt recipients, whereas corporations and certain other entities generally are exempt recipients. Payments made in respect of the Bonds to a U.S. beneficial owner must be reported to the IRS, unless such U.S. beneficial owner is an exempt recipient or establishes an exemption. Compliance with the identification procedures (described in the preceding section) would generally establish an exemption from backup withholding for those non-U.S. beneficial owners who are not exempt recipients.

In addition, upon the sale of a Bond to (or through) a broker, the broker must withhold at a rate of 31% of the reportable payment, unless either (i) the broker determines that the seller is a corporation or other exempt recipient or (ii) the seller provides, in the required manner, certain identifying information and, in the case of a non-U.S. beneficial owner, certifies that such seller is a non-U.S. beneficial owner (and certain other conditions are met). Such a sale must also be reported by the broker to the IRS, unless either (i) the broker determines that the seller is an exempt recipient or (ii) the seller certifies its non-U.S. status (and certain other conditions are met). Certification of the beneficial owner's non-U.S. status usually would be made on Form W-8 under penalties of perjury, although in certain cases it

may be possible to submit other documentary evidence. The term "broker" generally includes all persons who, in the ordinary course of a trade or business, stand ready to effect sales made by others, as well as brokers and dealers registered as such under the laws of the United States or a state. These requirements generally will apply to a United States office of a broker, and the information reporting requirements generally will apply to a foreign office of a United States broker, as well as to a foreign office of a foreign broker if the broker is (i) a controlled foreign corporation within the meaning of Section 957(a) of the Internal Revenue Code, (ii) a foreign person 50% or more of whose gross income from all sources for the 3-year period ending with the close of its taxable year preceding the payment (or for such part of the period that the foreign broker has been in existence) was effectively connected with the conduct of a trade or business within the United States or (iii) under the New Regulations (applicable with respect to payments made after 1999), a foreign partnership if it is engaged in a trade or business in the United States or if 50% or more of its income or capital interests are held by U.S. Persons.

Generally, any amounts withheld under the backup withholding rules from a payment to a beneficial owner would be allowed as a refund or credit against such beneficial owner's federal income tax.

## UNDERWRITERS

Subject to the terms and conditions set forth in the Underwriting Agreement relating to the Bonds (the “Underwriting Agreement”), TVA has agreed to sell to each of the Underwriters named

below (the “Underwriters”) and each of the Underwriters has severally agreed to purchase the principal amount of Bonds set forth opposite its name below:

<u>Name</u>	<u>Principal Amount of Bonds</u>
Morgan Stanley & Co. Incorporated	\$ 71,699,400
A.G. Edwards & Sons, Inc. ....	71,699,400
First Tennessee Bank National Association .....	71,699,400
PaineWebber Incorporated .....	71,699,400
Prudential Securities Incorporated ..	71,699,400
BT Alex. Brown Incorporated .....	2,057,000
Bear, Stearns & Co. Inc. ....	2,057,000
CIBC Oppenheimer Corp. ....	2,057,000
Credit Suisse First Boston Corporation .....	2,057,000
Donaldson, Lufkin & Jenrette Securities Corporation .....	2,057,000
Goldman, Sachs & Co. ....	2,057,000
Edward D. Jones & Co., L.P. ....	2,057,000
Lehman Brothers Inc. ....	2,057,000
Schroder & Co. Inc. ....	2,057,000
SG Cowen Securities Corporation ..	2,057,000
Warburg Dillon Read LLC.....	2,057,000
Advest, Inc. ....	1,028,000
Arthurs, Lestrangle & Company Incorporated .....	1,028,000
Robert W. Baird & Co. Incorporated .....	1,028,000
George K. Baum & Company .....	1,028,000
William Blair & Company, L.L.C. ..	1,028,000
Blaylock & Partners, L.P. ....	1,028,000
J.C. Bradford & Co. ....	1,028,000
Commerzbank Capital Markets Corporation .....	1,028,000
Compass Bank .....	1,028,000
Craigie Incorporated .....	1,028,000
Crowell, Weedon & Co. ....	1,028,000
Dain Rauscher Wessels .....	1,028,000
Davenport & Company LLC .....	1,028,000
D.A. Davidson & Co. Incorporated	1,028,000
Doley Securities, Inc. ....	1,028,000
Doft & Co., Inc. ....	1,028,000
EVEREN Securities, Inc. ....	1,028,000
Fahnestock & Co. Inc. ....	1,028,000
Ferris, Baker Watts, Incorporated ..	1,028,000
Fidelity Capital Markets, A Division of National Financial Services Corporation .....	1,028,000
Fifth Third Securities, Inc. ....	1,028,000

<u>Name</u>	<u>Principal Amount of Bonds</u>
First Albany Corporation .....	\$ 1,028,000
First Security Van Kasper.....	1,028,000
First Union Capital Markets Corp.	1,028,000
Fleet Securities, Inc. ....	1,028,000
Gibraltar Securities Co. ....	1,028,000
Gruntal & Co., L.L.C. ....	1,028,000
J.J.B. Hilliard, W.L. Lyons, Inc. ...	1,028,000
Janney Montgomery Scott Inc. ....	1,028,000
Josephthal & Co. Inc. ....	1,028,000
JWGenesis Securities, Inc. ....	1,028,000
Kirkpatrick, Pettis, Smith, Polian Inc. ....	1,028,000
LaSalle National Bank .....	1,028,000
Legg Mason Wood Walker, Incorporated .....	1,028,000
McDonald Investments Inc., A Keycorp Company .....	1,028,000
McGinn, Smith & Co., Inc. ....	1,028,000
Mesirow Financial, Inc. ....	1,028,000
Miller, Johnson & Kuehn, Incorporated .....	1,028,000
Morgan Keegan & Company, Inc.	1,028,000
NationsBanc Montgomery Securities LLC.....	1,028,000
Olde Discount Corporation .....	1,028,000
Ormes Capital Markets, Inc. ....	1,028,000
Pacific Crest Securities, Inc. ....	1,028,000
Parker/Hunter Incorporated .....	1,028,000
Pershing/Division of Donaldson, Lufkin & Jenrette .....	1,028,000
Pryor, McClendon, Counts & Co., Inc. ....	1,028,000
Ragen MacKenzie Incorporated....	1,028,000
Raymond James & Associates, Inc.	1,028,000
Redwood Securities Group, Inc. ...	1,028,000
The Robinson-Humphrey Company, LLC.....	1,028,000
Roney Capital Markets A Division of Banc One Capital Markets, Inc. ....	1,028,000
Charles Schwab & Co., Inc. ....	1,028,000
Scott & Stringfellow, Inc. ....	1,028,000
Muriel Siebert & Co., Inc. ....	1,028,000
Southwest Securities, Inc. ....	1,028,000
Stephens Inc. ....	1,028,000

<u>Name</u>	<u>Principal Amount of Bonds</u>
Sterne, Agee & Leach, Inc. ....	\$ 1,028,000
Stifel, Nicolaus & Company, Incorporated .....	1,028,000
Suntrust Equitable Securities Corporation .....	1,028,000
Sutro & Co. Incorporated .....	1,028,000
TD Securities (USA) Inc. ....	1,028,000
Tucker Anthony Incorporated ....	1,028,000

The Underwriting Agreement provides that the Underwriters' obligation to pay for and accept delivery of the Bonds is subject to approval of certain matters by its legal counsel and to certain other conditions. The Underwriters must buy all of the Bonds if they buy any.

TVA has granted the Underwriters an option exercisable for three Business Days after the date of this Offering Circular to purchase up to \$90,000,000 aggregate principal amount of additional PARRS to cover over-allotments, if any, at the initial price to public (less the underwriting discounts and commissions), as set forth on the cover page of this Offering Circular. If the Underwriters exercise their over-allotment option, the Underwriters have severally agreed, subject to certain conditions, to purchase approximately the same percentage thereof that the principal amount of PARRS to be purchased by each of them, as shown in the foregoing table, bears to the \$450,000,000 principal amount of PARRS offered hereby.

The Underwriters have advised TVA that they will initially offer the Bonds to the public at the price set forth on the cover page of this Offering Circular, and to certain dealers at the same price, less a concession not exceeding 2.00% of the principal amount. The Underwriters may allow and such dealers may reallow a discount not in excess of 1.60% of the principal amount of the Bonds to certain other dealers. After the initial public offering, the Underwriters may change the public offering price, concession and discount.

TVA has applied to list the Bonds on the New York Stock Exchange. Trading of the Bonds on the New York Stock Exchange is expected to com-

<u>Name</u>	<u>Principal Amount of Bonds</u>
U.S. Bancorp Piper Jaffray Inc. ...	\$ 1,028,000
Utendahl Capital Partners, L.P. ...	1,028,000
Wachovia Securities, Inc. ....	1,028,000
Wedbush Morgan Securities .....	1,028,000
The Williams Capital Group, L.P. ....	1,028,000
Total .....	<u>\$450,000,000</u>

mence within a 30-day period after the initial delivery thereof. In order to meet one of the requirements for listing the Bonds on the New York Stock Exchange, the Underwriters have undertaken to sell the Bonds to a minimum of 400 Beneficial Owners. TVA has been advised by the Underwriters that they presently intend to make a market in the Bonds, as permitted by applicable laws and regulations. The Underwriters are not obligated, however, to make a market in the Bonds, and any such market making may be discontinued at any time at the sole discretion of the Underwriters. Accordingly, no assurance can be given as to the liquidity of, or trading markets for, the Bonds.

In order to facilitate the offering of Bonds, the Underwriters may engage in transactions that stabilize, maintain or otherwise affect the price of the Bonds. Specifically, the Underwriters may over-allot in connection with the offering, creating a short position in the Bonds for their own account. In addition, to cover over-allotments or to stabilize the price of Bonds, the Underwriters may bid for and purchase Bonds in the open market. Any of these activities may stabilize or maintain the market price of the Bonds above independent market levels. The Underwriters are not required to engage in these activities and may end these activities at any time.

TVA has agreed to indemnify the Underwriters against certain civil liabilities or to contribute to the payments the Underwriters may be required to make respecting those liabilities.

From time to time, some of the Underwriters perform services for TVA in the normal course of business.

### VALIDITY OF BONDS

Edward S. Christenbury, Esq., General Counsel of TVA, will pass on the validity of the Bonds for TVA. Orrick, Herrington & Sutcliffe LLP, 666 Fifth Avenue, New York, New York 10103 will pass on the validity of the Bonds for the Underwriters. Orrick, Herrington & Sutcliffe LLP from time to time performs services for TVA in the ordinary course of business.

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All statements in this Offering Circular involving opinions, regardless of whether expressly so identified, are opinions only and not factual representations. This Offering Circular is not a contract or agreement with the purchaser of any of the Bonds.

### TENNESSEE VALLEY AUTHORITY

By:           /s/  DAVID N. SMITH            
David N. Smith  
*Chief Financial Officer*

Dated April 29, 1999

**SUMMARY ELECTION FORM**  
**(To be completed by the Financial Institution)**  
**TENNESSEE VALLEY AUTHORITY**  
**POWER BONDS 1999 SERIES A DUE MAY 1, 2029**  
**(PUTABLE AUTOMATIC RATE RESET SECURITIES)**  
**CUSIP NUMBER 880591 409**

*Capitalized terms used and not defined in  
this Summary Election Form shall have the meanings defined  
in the Offering Circular for the Bonds.*

To: Tennessee Valley Authority

The financial institution named below (the "Financial Institution"), on behalf of each of the beneficial owners named below (the "Beneficial Owners"), hereby exercises the option for repayment of the aggregate principal amount of Bonds designated below. To be valid, this Summary Election Form must be received by TVA at the office specified in the instructions for completing this Summary Election Form (together with the Option to Elect Repayment Form for each Beneficial Owner) *no earlier than* the relevant date on which TVA sends a notice of reset of the Coupon Rate (the "Reset Notification Date") and *no later than* the April 21 (or the prior Business Day if such date is not a Business Day) following the Reset Notification Date. This election shall have no effect with respect to (i) any Bonds for which an Option to Elect Repayment Form is not properly completed and delivered to TVA or (ii) any Bonds which are not timely returned to TVA as required in the instructions accompanying this Summary Election Form.

(1) \_\_\_\_\_  
Name of Financial Institution Requesting Repayment

(2) \_\_\_\_\_  
Aggregate Principal Amount of Bonds to be Repaid

(3) \_\_\_\_\_  
Date

(4) Financial Institution Representative: Name: Phone Number: Fax Number: Mailing Address(No P.O. Boxes):	(5) Name of The Depository Trust Company Direct Participant (if other than the Financial Institution):
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(6) Name of Beneficial Owner:	Principal Amount of Bonds to be Repaid:
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

(Continue on separate sheet if necessary.)

Election Number\* (to be completed by TVA): \_\_\_\_\_

\* Upon receipt of this Summary Election Form, TVA will assign an Election Number for the Bonds referred to above and return this Summary Election Form by facsimile to the party specified on line (4) above no later than two Business Days after receipt.

**TVA is an agency and instrumentality of the United States Government. The making of any false or fraudulent statement or representation to TVA is a violation of federal criminal law punishable by fine, imprisonment or both.**



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**OPTION TO ELECT REPAYMENT FORM**  
**(To be completed by the Financial Institution)**

**TENNESSEE VALLEY AUTHORITY**  
**POWER BONDS 1999 SERIES A DUE MAY 1, 2029**  
**(PUTABLE AUTOMATIC RATE RESET SECURITIES)**  
**CUSIP NUMBER 880591 409**

*Capitalized terms used and not defined in  
this election form shall have the meanings defined  
in the Offering Circular for the Bonds.*

To: Tennessee Valley Authority

The undersigned financial institution (the "Financial Institution") represents that (1) it has received a valid request for repayment from the beneficial owner listed below (the "Beneficial Owner") of Tennessee Valley Authority Power Bonds 1999 Series A Due May 1, 2029 (Putable Automatic Rate Reset Securities) (the "Bonds" — sometimes called "PARRS") and is currently authorized by the Beneficial Owner to put the Bonds listed below to TVA; and (2) the Beneficial Owner currently owns Bonds in the principal amount listed below, and the Financial Institution currently holds such Bonds through its account or through its agents with The Depository Trust Company.

The Financial Institution agrees to return the Bonds specified below through the book-entry system of The Depository Trust Company to TVA by the close of business on May 1 of the year of election (or the next succeeding Business Day, if such date is not a Business Day). The Financial Institution also agrees that (1) it shall follow the instructions accompanying this form; (2) it shall maintain records in accordance with reasonable industry practice and applicable law with respect to the request and authorization from the Beneficial Owner described in the preceding paragraph for a period of three years from the date of election listed below and shall allow TVA to inspect such records upon request; and (3) the Financial Institution shall indemnify and hold harmless TVA against and from any and all claims, liabilities, costs, losses, expenses, suits and damages resulting from any misrepresentation in this election form or other improper action by the Financial Institution in connection with the request for repayment.\*

- (1) \_\_\_\_\_  
Name of Beneficial Owner Requesting Repayment
- (2) \_\_\_\_\_  
Name of Financial Institution Requesting Repayment
- (3) \_\_\_\_\_  
Signature of Representative of Financial Institution Requesting Repayment  
(Must Be Notarized)
- (4) \_\_\_\_\_  
Principal Amount to Be Repaid
- (5) \_\_\_\_\_  
Date of Election

\* TVA may, in its sole discretion, impose any additional authentication requirements on any Financial Institution that fails to meet the record-keeping requirements set forth above.

**TVA is an agency and instrumentality of the United States Government. The making of any false or fraudulent statement or representation to TVA is a violation of federal criminal law punishable by fine, imprisonment or both.**

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**INSTRUCTIONS FOR EXERCISING THE REPAYMENT OPTION AND  
COMPLETING THE SUMMARY ELECTION FORM AND THE  
OPTION TO ELECT REPAYMENT FORM FOR  
TENNESSEE VALLEY AUTHORITY  
POWER BONDS 1999 SERIES A DUE MAY 1, 2029  
(PUTABLE AUTOMATIC RATE RESET SECURITIES)  
CUSIP NUMBER 880591 409**

*Capitalized terms used and not defined in  
these Instructions shall have the meanings defined  
in the Offering Circular for the Bonds.*

**General Instructions for Exercising the Repayment Option:**

The Financial Institution must:

1. Deliver a completed Summary Election Form, together with an original copy of the completed Option to Elect Repayment Form for each Beneficial Owner listed on such Summary Election Form, to:

Tennessee Valley Authority  
ATTN: Vice President and Treasurer  
400 West Summit Hill Dr.  
Knoxville, Tennessee 37902.

FACSIMILE TRANSMISSIONS WILL NOT BE ACCEPTED. To be valid, a properly completed Summary Election Form must be received by TVA at the above specified office *no earlier than* the relevant Reset Notification Date and *no later than* April 21 (or the prior Business Day, if such date is not a Business Day) following the Reset Notification Date.

Upon receipt of a Summary Election Form, TVA will assign an Election Number for the Bonds referred to therein and return the Summary Election Form by facsimile to the representative of the Financial Institution specified therein no later than two Business Days after receipt. *If a copy of the Summary Election Form, with the assigned Election Number, is not received by April 26 contact TVA at (423) 632-3366.*

2. Arrange for the aggregate principal amount of the Bonds set forth on the Summary Election Form to be returned to TVA through the book-entry system of The Depository Trust Company by the close of business on May 1 of the year of election (or the next succeeding Business Day, if such date is not a Business Day). If there is a delay in repayment of Bonds due to the fact that TVA cannot verify the receipt of Bonds by the close of business on the Return Date, TVA will not pay interest on such Bonds on or after the requested Return Date.

**Instructions for Completing the Summary Election Form:**

1. Indicate name of Financial Institution completing the Summary Election Form on line (1).
2. Indicate the aggregate principal amount of Bonds of all Beneficial Owners covered by the Summary Election Form on line (2).
3. Indicate the date the Summary Election Form was completed on line (3).
4. Indicate the name, mailing address (no P.O. boxes, please), telephone number and facsimile transmission number of the person to whom confirmation of these elections may be sent on line (4).
5. Indicate the name of The Depository Trust Company participant through which the Financial Institution holds the Bonds on line (5) (if the Financial Institution is not a Direct Participant in The Depository Trust Company).
6. Indicate the name of each Beneficial Owner requesting repayment and the principal amount of Bonds of each such Beneficial Owner to be repaid on line (6).

**Instructions for Completing the Option to Elect Repayment Forms:**

1. Indicate the name of the Beneficial Owner requesting repayment on line (1).
2. Indicate the name of the Financial Institution completing the Option to Elect Repayment Form on line (2).
3. Affix authorized signature of the Financial Institution's representative on line (3). *The signature must be notarized.*
4. Indicate the principal amount of Bonds to be repaid on line (4).
5. Indicate the date the Option to Elect Repayment Form was completed on line (5).

*For assistance with the Summary Election Form  
or the Option to Elect Repayment Form or any questions relating thereto,  
please telephone TVA at (423) 632-3366.*

## INFORMATION STATEMENT

### TENNESSEE VALLEY AUTHORITY

#### A Wholly Owned Corporate Agency and Instrumentality of the United States of America

The Tennessee Valley Authority ("TVA" or the "Corporation") presents this Information Statement (this "Statement") for the information of potential purchasers of (1) its Power Bonds ("New Power Bonds"), including its First Installment Series Bonds ("Installment Bonds" or "FISBS"), (2) its Discount Notes and (3) any other evidences of indebtedness ("Other Indebtedness") it may issue pursuant to the Tennessee Valley Authority Act of 1933, as amended (the "Act"). TVA issues New Power Bonds pursuant to the Act and the Basic Tennessee Valley Authority Power Bond Resolution adopted by the Board of Directors of TVA (the "Board") on October 6, 1960, as amended on September 28, 1976, October 17, 1989 and March 25, 1992 (the "Basic Resolution"). TVA issues Discount Notes and Other Indebtedness pursuant to the Act and their authorizing resolutions. New Power Bonds, Discount Notes and Other Indebtedness are collectively referred to in this Statement as "Evidences of Indebtedness".

TVA may offer New Power Bonds and Other Indebtedness from time to time. TVA may offer Discount Notes for sale on a continuous basis by direct placement or through selected investment dealers, dealer banks, underwriters or underwriting syndicates. For each offering of New Power Bonds, except for FISBS, TVA will prepare an offering circular describing the specific terms and conditions of the New Power Bonds offered. TVA will prepare a single offering circular that describes the general terms and conditions common to all FISBS offerings. TVA will also prepare a single offering circular describing the general terms and conditions common to all Discount Note offerings. For offerings of Other Indebtedness, TVA will either prepare an offering circular describing the specific terms and conditions of the particular offering or a more general offering circular, as TVA deems appropriate. You should read this Statement, as it may be supplemented or amended, together with the appropriate offering circular, as it may be supplemented or amended, for each offering.

For each offering of an Evidence of Indebtedness, you should rely only on the information contained in (1) this Statement, (2) the relevant offering circular and (3) any supplements or amendments to these documents approved by TVA. TVA has not authorized anyone to provide you with any information that is different from that found in this Statement and each relevant offering circular. This Statement does not constitute an offer to sell or a solicitation of an offer to buy any Evidences of Indebtedness in any jurisdiction to any person to whom it is unlawful to make an offer or solicitation.

This Statement is accurate only as of its date. TVA will supplement, amend or replace this Statement from time to time to reflect its annual financial results or otherwise as TVA deems appropriate. However, TVA assumes no further duty to update this Statement. You should rely on the most recent supplements or amendments to or replacement of this Statement over different information in this Statement.

You may obtain additional copies of this Statement by writing to Tennessee Valley Authority, 400 West Summit Hill Drive, Knoxville, Tennessee 37902, Attention: Vice President and Treasurer or by calling (423) 632-3366.

***Evidences of Indebtedness are not obligations of the United States of America, and the United States of America does not guarantee the payment of the principal of or interest on any Evidences of Indebtedness. TVA is not required to register Evidences of Indebtedness under the Securities Act of 1933 or to make periodic reports to the Securities and Exchange Commission under the Securities Exchange Act of 1934. TVA does not intend to register any of its Evidences of Indebtedness or file any reports with the Securities and Exchange Commission.***

**The date of this Information Statement is February 16, 1999.**



## FORWARD-LOOKING STATEMENTS

This Statement contains forward-looking statements relating to future events and future performance. Any statements regarding expectations, beliefs, plans, projections, estimates, objectives, intentions or assumptions or otherwise relating to future events or performance may be forward-looking. Some examples include statements regarding TVA's projections of future power and energy requirements, future costs related to environmental compliance, targets for TVA's future competitive position and the potential effect of the Year 2000 issue on TVA's operations. Although TVA believes that the assumptions underlying the forward-looking statements in this Statement are reasonable, TVA does not guarantee the accuracy of these statements. Numerous factors could cause actual results to differ materially from those in forward-looking statements. Such factors include, among other things, new laws and regulations, especially those related to the restructuring of electric utilities and various environmental matters; increased competition among electric utilities; legal and administrative proceedings affecting TVA; the financial environment; performance of TVA's generating facilities; fuel prices; the demand for electricity; weather conditions; changes in accounting standards; the efficacy of TVA's year 2000 remediation efforts and the efforts of those entities with which TVA interfaces; and unforeseeable events.

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## TENNESSEE VALLEY AUTHORITY

TVA is one of the largest wholesalers of electric power in the United States, having produced over 155 billion kilowatt-hours (“kWh”) of electricity in fiscal 1998. TVA is a wholly owned corporate agency and instrumentality of the United States of America established by the Act to develop the resources of the Tennessee Valley region.

Historically, the programs at TVA have consisted of power and nonpower programs. Financial accounts for these two types of programs have been kept separately. Substantially all of TVA’s revenues and assets are attributable to its power program.

The Act requires the power program to be self-supporting from power system revenues and capital TVA raises through its power program borrowings. The Act authorizes TVA to issue Evidences of Indebtedness in an amount not exceeding \$30 billion outstanding at any one time, the proceeds of which may be used only for the power program. See “The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness”.

Congressional appropriations have provided most of the funding for TVA’s nonpower programs. TVA has obtained additional funds from revenues and user fees from the nonpower programs. In 1997, Congress enacted appropriations legislation that anticipated no further appropriations for the nonpower programs in fiscal years following 1998. This legislation required TVA, in the absence of appropriations, beginning in fiscal 1999, to fund certain nonpower programs constituting essential stewardship activities from various sources, which may include power revenues. Because Congress appropriated \$50 million for TVA’s nonpower programs for fiscal 1999, TVA has not yet used power funds for its essential stewardship activities but may do so in the future. For a further discussion of this matter see “The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness” — “Recent Legislation”.

Congress reserved the right in the Act to alter, amend or repeal the Act but provided that no amendment or repeal shall operate to impair the obligation of any contract made by TVA in the

exercise of any power conferred by the Act. For a discussion of recent legislation relating to the TVA Act, see “The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness” — “Recent Legislation”.

TVA is administered by a board of three persons appointed by the President and confirmed by the Senate. Appointments are for nine-year staggered terms, with one term expiring each three-year interval. The Board has the sole authority to determine the rates TVA charges for power. The Act requires the rates to be sufficient to cover certain expenses. See “The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness” — “Rate Covenant”.

The Act requires TVA to annually file a financial statement and complete report as to the business of the Corporation with the President and Congress. The Act authorizes the Comptroller General of the United States to periodically audit the transactions of TVA.

Under certain circumstances, the Act permits TVA to borrow up to \$150 million for a period of one year or less from the U.S. Treasury. The Act requires TVA to obtain the approval of the Secretary of the U.S. Treasury of the issue date and maximum interest rate for any issuance of an Evidence of Indebtedness with a term of one year or longer. The Office of Management and Budget treats TVA’s borrowing authority as budget authority for purposes of the budget of the United States.

Income on Evidences of Indebtedness issued by TVA is subject to federal income taxation and various other federal tax consequences. There is no special exemption for Evidences of Indebtedness from federal estate and gift taxes. Under the Act, Evidences of Indebtedness are exempt both as to principal and interest from all taxation now or hereafter imposed by any state or local taxing authority except estate, inheritance and gift taxes. This exemption might not extend to franchise or other non-property taxes imposed on corporations or to gain or loss realized upon the sale or exchange of an Evidence of Indebtedness even though such gain might in some cases be treated as interest income for United States federal income tax purposes.

## SELECTED FINANCIAL DATA

The following selected financial data of TVA's power program for the fiscal years 1994 through 1998 have been derived from TVA's audited financial statements. These data should be read in conjunction with the audited financial statements and notes thereto (the "Financial Statements") presented herein.

### Condensed Statements of Income (in millions)

	Fiscal Year Ended September 30,				
	1998	1997	1996	1995	1994
Operating Revenues .....	\$ 6,729	\$ 5,934	\$ 5,951	\$ 5,473	\$ 5,546
Operating Expenses .....	4,549	4,080	3,914	3,546	3,606
Operating Income .....	2,180	1,854	2,037	1,927	1,940
Other Income (Expense), Net .....	12	157	(10)	(91)	(59)
Income Before Interest Expense .....	2,192	2,011	2,027	1,836	1,881
Net Interest Expense .....	1,959	2,003	1,966	1,826	1,730
Net Income .....	<u>\$ 233</u>	<u>\$ 8</u>	<u>\$ 61</u>	<u>\$ 10</u>	<u>\$ 151</u>

### Condensed Balance Sheet (in millions)

	September 30,				
	1998	1997	1996	1995	1994
<b>Assets</b>					
Current Assets .....	\$ 1,656	\$ 1,399	\$ 1,306	\$ 1,088	\$ 1,025
Property, Plant, and Equipment .....	28,891	29,298	29,521	29,301	28,071
Investment Funds .....	578	561	440	260	150
Deferred Charges and Other Assets .....	2,490	2,426	2,762	2,644	2,596
TOTAL ASSETS .....	<u>\$33,615</u>	<u>\$33,684</u>	<u>\$34,029</u>	<u>\$33,293</u>	<u>\$31,842</u>
<b>Liabilities and Proprietary Capital</b>					
Current Liabilities .....	\$ 4,440	\$ 3,853	\$ 5,101	\$ 5,416	\$ 4,591
Other Liabilities .....	2,007	1,704	1,580	1,264	963
Long-Term Debt .....	23,020	24,152	23,320	22,583	22,206
Proprietary Capital .....	4,148	3,975	4,028	4,030	4,082
TOTAL LIABILITIES AND PROPRIETARY CAPITAL .....	<u>\$33,615</u>	<u>\$33,684</u>	<u>\$34,029</u>	<u>\$33,293</u>	<u>\$31,842</u>

**COMPARATIVE FIVE-YEAR DATA  
STATISTICAL AND FINANCIAL SUMMARIES**

	For the Years Ended September 30,				
	1998	1997	1996	1995	1994
<b>Sales (millions of kWh) (a)</b>					
Municipalities and cooperatives .....	123,330	114,771	117,035	110,245	108,073
Industries directly served .....	18,514	17,359	16,599	16,684	15,792
Federal agencies and other .....	21,293	27,198	19,964	12,356	13,599
Total sales .....	<u>163,137</u>	<u>159,328</u>	<u>153,598</u>	<u>139,285</u>	<u>137,464</u>
<b>Operating revenues (millions of dollars) (a)</b>					
Electric					
Municipalities and cooperatives .....	\$5,554	\$4,811	\$4,980	\$4,654	\$4,582
Industries directly served .....	523	464	452	460	452
Federal agencies and other .....	556	561	430	277	441
Other .....	96	98	89	82	71
Total revenues .....	<u>\$6,729</u>	<u>\$5,934</u>	<u>\$5,951</u>	<u>\$5,473</u>	<u>\$5,546</u>
Electric revenue per kWh (cents) (b) .....	4.07	3.66	3.82	3.87	3.87
<b>Winter net dependable generating capacity (megawatts)</b>					
Hydro(c) .....	5,491	5,384	5,298	5,225	5,242
Fossil .....	15,003	15,014	15,012	15,032	15,032
Nuclear units in service .....	5,620	5,625	5,545	3,342	3,342
Combustion turbine .....	2,384	2,394	2,268	2,232	2,264
Total capacity .....	<u>28,498</u>	<u>28,417</u>	<u>28,123</u>	<u>25,831</u>	<u>25,880</u>
<b>System peak load (megawatts) — summer ...</b>	27,253	26,661	25,376	25,496	23,398
<b>System peak load (megawatts) — winter ....</b>	23,204	26,670	25,995	24,676	24,723
<b>Percent gross generation by fuel source</b>					
Fossil .....	62%	61%	65%	71%	72%
Hydro .....	10%	11%	11%	12%	14%
Nuclear .....	28%	28%	24%	17%	14%
<b>Fuel cost per kWh (cents)</b>					
Fossil .....	1.25	1.23	1.23	1.26	1.34
Nuclear(d) .....	.71	.58	.56	.61	1.10
Aggregate fuel cost per kWh net thermal generation .....	1.10	1.04	1.06	1.14	1.31
<b>Fuel data</b>					
Net thermal generation (millions of kWh) ...	139,727	135,735	131,898	118,097	110,643
Billion Btu .....	1,426,151	1,381,837	1,338,157	1,197,295	1,120,868
Fuel expense (millions of dollars) .....	1,538	1,406	1,395	1,348	1,450
Cost per million Btu (cents) .....	107.81	101.73	104.22	112.61	129.40
Net heat rate, fossil only .....	10,207	10,180	10,145	10,138	10,131

(a) Sales have been adjusted to include sales to other utilities.

(b) Excludes Department of Energy settlement payment of \$160 million for 1994.

(c) Includes 405 megawatts of dependable capacity from the Corps of Engineers projects on the Cumberland River System.

(d) TVA changed its method of expensing the interest component of nuclear fuel expense in 1995.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Results of Operations

#### *Operating Environment*

Net income for fiscal 1998 amounted to \$233 million, an increase of \$225 million from net income of \$8 million in fiscal 1997. The increase in earnings resulted primarily from a rate increase effective October 1, 1997, coupled with relatively hotter weather during the summer of 1998. Net income for fiscal 1997 was \$8 million compared with \$61 million for fiscal 1996. This decline was primarily driven by mild weather in fiscal 1997 compared to fiscal 1996.

#### *Operating Revenues*

Operating revenues were \$6,729 million in fiscal 1998 compared with \$5,934 million in fiscal 1997. The \$795 million increase was primarily due to additional revenues from the fiscal 1998 rate increase, coupled with an increase in energy sales to municipalities and cooperatives as a result of the hot summer during fiscal 1998. The TVA service area experienced 2.2 percent greater heating degree days and 46.2 percent greater cooling degree days during fiscal 1998 compared with fiscal 1997. Accordingly, total kilowatt-hour sales excluding off-system sales increased 7.7 billion kWh, from 139.7 billion in fiscal 1997 to 147.4 billion in fiscal 1998.

The \$17 million decrease in operating revenues from fiscal 1996 to fiscal 1997 was primarily due to a decrease in kWh sales excluding off-system sales of approximately 0.9 billion kWh, from 140.6 billion in fiscal 1996 to 139.7 billion in fiscal 1997. The decrease in kWh sales primarily resulted from milder weather conditions in fiscal 1997 compared to fiscal 1996.

#### *Operating Expenses*

Operating expenses increased \$469 million, or 11.5 percent, from \$4,080 million in fiscal 1997 to \$4,549 million in fiscal 1998. The increase in operating expenses is primarily due to higher fuel and purchased power expense in fiscal 1998 as a result of higher system generation and greater purchases of power at higher prices, coupled with an increase in operating and maintenance expense.

Total operating expenses increased \$166 million in fiscal 1997, or 4.2 percent, from \$3,914

million in fiscal 1996 to \$4,080 million in fiscal 1997. The operation of the Watts Bar Unit One and Browns Ferry Unit Three nuclear units for the entire year of fiscal 1997 resulted in higher depreciation and operating expenses in fiscal 1997 compared with fiscal 1996.

#### *Other Income and Expenses*

TVA had net other income of \$12 million in fiscal 1998 compared with net other income of \$157 million in fiscal 1997 and expense of \$10 million in fiscal 1996. The fiscal 1997 net other income consisted primarily of investment earnings of the decommissioning trust funds of \$138 million.

#### *Interest Expense*

Gross interest expense declined \$70 million from \$2,084 million in fiscal 1997 to \$2,014 million in fiscal 1998. Total outstanding indebtedness, net of unamortized discounts and certain other adjustments as of September 30, 1998, was \$26.3 billion, with an average interest rate of 7.45 percent, compared with \$26.9 billion, with an average interest rate of 7.56 percent as of September 30, 1997. The allowance for funds used during construction decreased from \$81 million in fiscal 1997 to \$55 million in fiscal 1998 as a result of the continued decline in overall construction spending.

Gross interest expense for fiscal 1997 remained relatively unchanged from fiscal 1996, resulting from a relatively constant level of outstanding debt of \$27.3 billion as of September 30, 1996, compared with \$26.9 billion as of September 30, 1997. In addition, allowance for funds used during construction declined \$36 million from \$117 million in fiscal 1996 to \$81 million in fiscal 1997.

### Liquidity and Capital Resources

#### *Capital Structure*

During the first 25 years of TVA's existence, the U.S. Government made appropriation investments in TVA power facilities. In 1959, TVA received congressional approval to issue bonds to finance its growing power program. For the last four decades, TVA's power program has been required to be self-supporting from revenues and capital it raised through its issuance of debt. As a result,

TVA funds its capital requirements through internal cash generation or through borrowings (subject to a congressionally mandated limit of \$30 billion outstanding at any one time).

A return on the U.S. Government's initial appropriation investment in TVA power facilities, plus a repayment of the initial investment, is specified by law. The payment for fiscal 1998 was \$60 million, and total cumulative repayments and return on investment by TVA to the U.S. Treasury exceed \$3 billion.

#### *Capital Expenditures*

Cash required by TVA for capital expenditures totaled \$582 million, \$641 million and \$990 million for fiscal 1998, 1997 and 1996, respectively. The reductions reflect the decline in construction spending resulting from the return of Browns Ferry Unit Three to commercial operation in January 1996, the commencement of commercial operation at Watts Bar Unit One in May 1996 and the Board's decision not to complete by itself or restart certain other nuclear units. See "Nuclear Power Program" — "Status of Certain Nuclear Units". TVA's current forecast for capital expenditures, including capitalized interest, totals \$828 million for fiscal 1999, which it expects to fund from internally generated funds.

#### *Financing Activities*

Long-term debt and cash from operations are used to finance capital expenditures. Short-term debt and cash from operations are used to manage daily cash needs. In fiscal 1998 TVA issued \$4.6 billion in long-term bonds, the proceeds of which were used to refinance existing debt.

In October 1998, TVA issued in the public market \$250 million in Power Bonds (due 2001) to retire existing debt.

In November 1998, TVA issued in the public market \$2 billion in Global Power Bonds (due 2008) to retire existing debt.

In December 1998, TVA issued in the public market £200 million in Global Power Bonds (due 2021) and \$400 million in Power Bonds (due 2003) to retire existing debt. In connection with the issuance of its £200 million in Global Power Bonds, TVA entered into a currency swap agreement to hedge its foreign currency exposure.

In fiscal 1998, TVA monetized the call provisions on approximately \$2 billion of its Power Bonds. The premiums received by TVA have been deferred and are being amortized over the terms of the agreements.

#### *Cash Flows*

Net cash provided by operations for fiscal 1998, fiscal 1997 and fiscal 1996 was \$1,394 million, \$1,066 million and \$910 million, respectively. This positive trend reflects improvements made in TVA's operations during the three-year period coupled with the rate increase in fiscal 1998.

Net cash used in investing activities for fiscal 1998, fiscal 1997 and fiscal 1996 was \$742 million, \$580 million and \$1,254 million, respectively. These changes reflect the annual decreases in construction spending, as well as the fiscal 1997 sale of certain receivables.

Net cash (used in)/provided by financing activities for fiscal 1998, 1997 and 1996 was \$(560) million, \$(425) million and \$530 million, respectively. The cash used in financing activities during fiscal 1997 and 1998 reflects the aggregate repayment of total outstanding debt of over \$1 billion.

#### **Accounting Standards**

##### *Accounting for the Effects of Regulation*

TVA accounts for the financial effects of regulation in accordance with Statement of Financial Accounting Standards ("SFAS") No. 71, *Accounting for the Effects of Certain Types of Regulation*. As a result, TVA records certain regulatory assets and liabilities that would not be recorded on the balance sheet under generally accepted accounting principles for non-regulated entities.

TVA has approximately \$1.9 billion of regulatory assets (see note 1 of the accompanying Financial Statements) along with approximately \$6.3 billion of deferred nuclear plants as of September 30, 1998. In the event that competition in the utility industry changes the application of SFAS No. 71, TVA would be required to evaluate such regulatory assets and deferred nuclear plants under the provisions of SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of*. Statement 121 establishes requirements for evaluating and measuring asset impairments and states that regulatory assets that are no longer probable of recovery



through future revenues be charged to earnings. Such an event may have a material adverse effect on future results of operations from the write-off of regulatory assets. However, TVA intends to seek full recovery of any regulatory assets that may result from TVA's transition to doing business in the competitive market.

#### *New Accounting Pronouncements*

The Financial Accounting Standards Board ("FASB") has recently issued the following statements that will be applicable to TVA:

Statement of Financial Accounting Standards No. 130, *Reporting Comprehensive Income*, which is effective for fiscal years beginning after December 15, 1997. This statement establishes standards for reporting and display of comprehensive income and its components. Comprehensive income includes, but is not limited to, foreign currency translation adjustments and unrealized holding gains and losses on available-for-sale securities. TVA will adopt this statement in fiscal 1999 and such adoption is not expected to have a material effect on TVA's financial position or results of operations.

Statement of Financial Accounting Standards No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits*, which is intended to improve the effectiveness of current footnote disclosure requirements for employers' pensions and other retiree benefits. This statement is effective for fiscal years beginning after December 15, 1997, although earlier application is encouraged. While this statement will result in additional financial disclosures, it will not impact TVA's financial position or results of operations (see note 7 of the accompanying Financial Statements).

In June 1998, FASB issued SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. The statement established accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded on the balance sheet as either an asset or liability measured at its fair value. The statement requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. TVA may engage in hedging activities using futures, forward contracts, options and swaps to hedge the impact of

market fluctuations on energy commodity prices, interest rates and foreign currencies. TVA is currently assessing the effect, if any, on its financial statements of implementing SFAS No. 133. TVA will be required to adopt the statement in fiscal 2000.

In March 1998, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants issued Statements of Position ("SOP") 98-01, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, which provides guidance on accounting for the costs of computer software developed or obtained for internal use. Under SOP 98-01, certain costs which are currently expensed may now be capitalized and amortized over some future period. The SOP is effective for fiscal years beginning after December 15, 1998, although earlier application is encouraged. The impact of the application of the provisions of this statement on TVA's financial position or results of operations upon its adoption is not known at this time.

#### *Nuclear Decommissioning Costs*

FASB has reached several tentative conclusions with respect to its project regarding the accounting for closure and removal of long-lived assets, including the decommissioning of nuclear generating units. It is uncertain when the final statement will be issued and what impact it may ultimately have on TVA's financial position or results of operations. Effective for fiscal 1998, TVA changed its method of accounting for decommissioning costs and related liabilities in order to comply with certain of the FASB's tentative conclusions, as well as certain rate-setting actions. TVA's current accounting policy recognizes all obligations related to closure and removal of its nuclear units as incurred. The liability for closure is measured as the present value of the estimated cash flows required to satisfy the related obligation and discounted at a determined risk-free rate of interest. The corresponding charge to recognize the additional obligation was effected through the creation of a regulatory asset. TVA further modified its method of accounting for decommissioning costs such that earnings from decommissioning fund investments, amortization expense of the decommissioning regulatory asset and interest expense on the decommissioning liability are deferred in accordance with SFAS No. 71.

## THE AREA SUPPLIED BY TVA

TVA supplies power in most of Tennessee, northern Alabama, northeastern Mississippi, and southwestern Kentucky, and in small portions of Georgia, North Carolina and Virginia. TVA serves a population of about 8 million people. Subject to certain minor exceptions, TVA may not without specific authorization by act of Congress enter into contracts which would have the effect of making it or the distributors of its power a source of power supply outside the area for which TVA or the distributors were the primary source of power supply on July 1, 1957.

TVA is primarily a wholesaler of power. Its customers are composed of three major groups: (1) distributors, consisting of municipal and cooperative systems; (2) industries that have large or unusual loads and (3) federal agencies. Additionally, TVA has entered into exchange power arrangements with most of its surrounding electric systems.

## RATES, CUSTOMERS AND MARKET

The Act gives the Board sole responsibility for establishing the rates that TVA charges for power and authorizes the Board to include in power contracts terms and conditions that it judges necessary or desirable for carrying out the purposes of the Act. The Act requires TVA to charge rates for power which, among other things, will produce gross revenues sufficient to provide funds for (1) operation, maintenance and administration of its power system; (2) payments to states and counties in lieu of taxes; (3) debt service on outstanding Evidences of Indebtedness; and (4) annual payments to the United States Treasury (the "Treasury") in repayment of and as a return on the Government's appropriation investment in TVA power facilities (the "Appropriation Investment"). See "Certain Provisions of the Tennessee Valley Authority Act" and "The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness" — "Rate Covenant" and "Recent Legislation". Rates set by the Board are not subject to review or approval by any state or federal regulatory body. See "Competition".

A summary of power program operating revenues by customer type for each of the last five fiscal years ended September 30 is shown in the Comparative Five-Year Data presented on page 3.

## Municipal and Cooperative Distributors

Sales to municipal and cooperative distributors accounted for approximately 83 percent of TVA's power revenues in fiscal 1998. TVA has long-term wholesale power contracts with 159 municipal and cooperative distributors. All of these contracts are for terms of 20 years and require distributors to purchase substantially all of their electric power and energy requirements from TVA.

All distributors purchase power under one of three basic arrangements. Fifty-seven distributors purchase power under contracts that require 10 years' notice to terminate and further provide that on each anniversary beginning on the tenth anniversary, one additional year is automatically added to the term. Four distributors have contracts that require 15 years' notice to terminate the contract. On each anniversary of these contracts, beginning on the fifth anniversary, one additional year is automatically added to the term. TVA has also offered distributors the option of moving from 10- or 15-year termination notice periods to a 5-year termination notice period. These contract amendments are conditioned upon notice not being given during the first 5 years after the effective date of the revision. Ninety-eight distributors have entered into contractual arrangements of this type. TVA has agreed that all of these term arrangements are deemed to provide for adequate recovery by TVA of any investment in generation, transformation or transmission facilities for service to the distributor.

A number of TVA distributors, including some with the largest loads, have expressed interest in further revising their wholesale power contracts to allow them more options respecting contract term and other matters, such as purchasing only a portion of their power requirements from TVA. TVA has indicated its willingness to work with distributors to accommodate their desire for more flexibility. For a discussion of events that may affect TVA's relationships with the distributors of its power, see "Competition".

TVA's wholesale power contracts contain standard provisions specifying the wholesale rates, resale rates and terms and conditions under which power is to be distributed. Under these contracts, TVA, on a quarterly basis, may determine and make adjustments in the wholesale rate schedule with corresponding adjustments in resale rate schedules necessary to enable TVA to meet all requirements of the Act and the tests and provisions of its bond resolutions. The contracts provide for agreement

between the parties on general or major changes in both the wholesale and resale rate schedules. If, however, agreement is not reached, the contracts permit TVA to make changes in these schedules to carry out the objectives of the Act, to meet financial requirements and tests and to comply with the provisions of its bond resolutions.

The power contracts between TVA and the distributors of TVA power specify the resale rates that distributors charge the ultimate power consumers. These rates are revised from time to time to reflect changes in costs, including changes in the wholesale cost of power. They are designed to promote the Act's objective of providing an adequate supply of power at the lowest feasible rates.

### **Other Sources of Power Revenues**

Revenues from industries and federal agencies directly served and from exchange power arrangements with other power systems accounted for approximately 17 percent of TVA's power revenues in fiscal 1998. Contracts with industries directly served by TVA are normally for 10-year terms. These contracts are subject to termination by TVA or the customer upon a minimum notice period that varies according to the customer's contract demand and the period of time service has been provided to the location where it is to be terminated. TVA establishes the rates it charges industries it directly serves. These rates are the same as those charged by the distributors of TVA power to large industries (those with demand greater than 25,000 kilowatts). TVA sells power to federal agencies under the same contract terms and rates as directly served industries. TVA has exchange power arrangements with 14 neighboring power systems. See note 1 of the accompanying Financial Statements.

### **COMPETITION**

The electric utility industry has become increasingly competitive over the last decade. Competition is expected to continue to intensify, and restructuring legislation may dramatically change the way electric utilities do business in the future. Among the early initiatives that have begun to promote competition is the Energy Policy Act of 1992 (the "Energy Act"). The Energy Act, and related Federal Energy Regulatory Commission ("FERC") orders, already allow competitors of a utility to access that utility's transmission system to

sell electricity to other electric power suppliers and customers. The Energy Act also amended the Public Utility Holding Company Act of 1935 to allow the creation of certain types of power generating entities without the entities or their parent corporations being subject to regulation by the Securities and Exchange Commission under that act.

Currently, TVA may not enter into contracts that would have the effect of making it or the distributors of its power a source of power supply outside its current service area. However, under a special provision of the Energy Act (the "anti-cherry picking provision"), TVA is not required to provide its competitors access to its transmission system to transmit power within the area that TVA or the distributors of its power may serve (except for Bristol, Virginia). Thus, while TVA may not sell power outside its current service area, its competitors are not allowed to use its transmission system to sell power within most of TVA's service area.

In the future, it is likely that the current law that serves to limit competition between TVA and its competitors will change. In the past two years, numerous bills have been introduced in Congress designed to restructure the electric utility industry and mandate or promote competition in the industry. Passage of these types of bills would result in other major changes in the electric power industry that would significantly impact both privately owned companies and publicly and consumer owned electric power suppliers like TVA and the distributors of TVA power. The amount of government regulation, particularly for the publicly and consumer owned power suppliers, would greatly increase. Despite their purpose to increase competition, some bills that have been introduced would not permit TVA and the distributors of its power to compete for customers outside the area for which TVA may currently be a source of power supply but would allow others to compete for customers of TVA and the distributors of its power. Hearings on various topics of competition and electric industry restructuring have been held in the House and Senate. TVA anticipates that in the event any restructuring legislation is enacted, such legislation would enable TVA and the distributors of its power to take part, reciprocally, in competition outside the area for which they can now be a source of electric power supply.

Restructuring legislation raises serious issues for TVA, as it does for the rest of the electric utility industry. Among the issues which could have the greatest impact on the TVA system are (1) whether TVA will have the right to recover its power system investments that would no longer be economical under full and open market competition; (2) whether TVA and the distributors of TVA power will be able to sell power outside the TVA service area; (3) whether Congress will attempt to shorten the terms of TVA's present wholesale power contracts with the distributors of its power and (4) whether TVA rates will be regulated by FERC.

On March 25, 1998, the Clinton administration addressed some of these issues in its proposed Comprehensive Electricity Competition Plan (the "Competition Plan"). The plan discusses various aspects of national retail competition in the electric power industry, including extension of the general regulatory authority of FERC to cover transmission service by cooperatives and all government-owned electric systems, including TVA. Additionally, the Competition Plan notes that the Clinton administration is considering issues relating to the role that the TVA power system should play in the electric power industry after nationwide competition has begun. The Competition Plan further notes that the administration expects the recommendations of the Tennessee Valley Electric System Advisory Committee (the "Advisory Committee") regarding TVA to provide the administration with a broad framework for bringing competition to TVA and restructuring its operations. The Advisory Committee is a subcommittee of the Secretary of Energy's Advisory Board and includes representatives of TVA, TVA employees, TVA customers, neighboring power systems, power marketers and various interest groups in the Tennessee Valley.

Shortly after the release of the Competition Plan, the Advisory Committee released its recommendations regarding TVA. The Advisory Committee members agreed, among other things, that (1) TVA should be subject to FERC transmission jurisdiction comparable to that imposed on other transmitting utilities; (2) TVA should, to some extent, be subject to federal antitrust laws; (3) distributors or their customers should pay some type of excise tax in place of taxes on gross receipts or "in lieu of tax" payments by producers; (4) TVA should relinquish its role of regulating retail power

sales; (5) the anti-cherry picking provision and the territorial limitations that restrict the area in which TVA and the distributors of its power may be a source of power (the "fence") should be removed concurrently with the implementation of retail competition; (6) TVA should remain primarily a wholesaler of electricity and (7) any stranded costs resulting from mandated competition should be borne by the customers of TVA or the distributors of TVA power for whom TVA incurred the costs, subject to review by FERC or another federal authority. The Advisory Committee members did not agree on numerous other issues such as (1) the conditions under which TVA should become subject to FERC transmission jurisdiction; (2) TVA's ability to set its wholesale rates; (3) the extent to which TVA should be subject to federal antitrust laws, labor laws and income tax; (4) the identity of the entity or entities responsible for regulating retail rates; (5) the nature of TVA's mission; (6) the authority of TVA to build new generation capacity; (7) the extent to which the anti-cherry picking provision and the fence should be removed if retail competition is delayed; (8) the terms of TVA's wholesale power contracts; (9) the extent to which TVA should be able to serve retail customers and (10) certain other issues regarding the status and powers of TVA.

A June 1998 draft bill prepared by the House Commerce Committee staff for Representatives Largent and Paxon has many provisions that parallel those to which members of the Advisory Committee agreed in principle. Nevertheless, the Largent draft differs significantly in several respects by providing that (1) sales of power outside the fence could be made only under limited conditions; (2) new generating resources greater than 50 megawatts could be acquired by TVA only if the customers for whose benefit the resources are acquired contractually or financially commit to paying the full cost of the resources; (3) significant transmission investments would require FERC approval; (4) the recovery of stranded costs would be based on FERC's lost-revenue methodology rather than on the competitive-rate methodology, on which the TVA Ten-Year Business Plan is premised and (5) FERC would be provided broad additional authority to issue regulations and orders related to the management and operation of the TVA power system.

TVA expects that bills such as the draft bill prepared for Representatives Largent and Paxon



and others will be introduced during 1999 and that restructuring legislation will receive serious congressional consideration. The date of final action on such legislation remains uncertain.

In January 1998, TVA and the Tennessee Valley Public Power Association (the "TVPPA"), which represents the interests of distributors of TVA power, issued a joint statement indicating their consensus regarding legislative positions on the restructuring of the electric utility industry. The statement recommends, among other things, that in the event customer choice legislation is enacted at the federal level: (1) the anti-cherry picking provision of the Energy Act and the fence be removed, provided that (a) the distributors' contracts are modified to shorten terms and termination notice and to allow distributors to purchase partial requirements from TVA, (b) the issue of stranded investment is addressed and (c) TVA is required to grant access to its transmission system at reasonable charges to permit power to be transmitted to or on behalf of the distributors; (2) any recovery of TVA's stranded investment costs be subject to FERC approval, not be allowed prior to termination of a contract, and not be allowed after October 1, 2007 unless TVA and the distributor otherwise agree; (3) TVA's rights to serve new retail customers be subject to certain conditions and restrictions based on distributors' power purchasing relationship with TVA; (4) TVA generally be required to offer long-term, all-requirements power to distributors at wholesale rates no less favorable than that offered to new wholesale customers; (5) TVA continue to have the statutory authority to set certain terms and conditions in its all-requirements wholesale power contracts with distributors so as to facilitate the TVA Act's mandate that TVA power be distributed at the lowest feasible rates and (6) TVA have no authority to approve retail rates or other conditions of retail service except under certain limited circumstances.

Representatives of three of the largest distributors of TVA power, the municipal power systems of Knoxville, Memphis and Nashville, Tennessee, have also expressed positions on issues concerning restructuring of the electric utility industry, some of which differ from the positions set forth in the joint statement issued by TVA and TVPPA.

TVA anticipates that discussions with distributors regarding a wide range of issues involving the restructuring of the electric utility industry, in-

cluding the issues noted above, will continue throughout the national restructuring process.

In today's competitive environment, some of the municipal and cooperative distributors may consider alternative wholesale supply arrangements upon expiration or termination of their power contracts with TVA. In February 1997, the city council of Bristol, Virginia ("Bristol") approved a recommendation from the Bristol Virginia Utilities Board that Bristol accept an offer from Cinergy to supply its power in the future. On December 31, 1997, the power contract between TVA and Bristol ended, and Bristol ceased being a distributor of TVA power.

TVA's management has developed and will continue to develop plans and strategies it believes will help position TVA to successfully compete in a restructured electricity market both within the Tennessee Valley and nationwide. In July 1997, TVA released its Ten-Year Business Plan that set targets for reducing total cost of power, through debt reduction and other means, by 2007. TVA's total cost of power for fiscal 1998 was approximately 4 cents per kWh. As of September 30, 1998, TVA had reduced its total debt by more than \$1 billion since September 30, 1996. These achievements reflect performance in line with the plan's targets. The plan was built on reasonable assumptions; however, numerous factors, such as those described in the "Forward-Looking Statements" section of this Statement, could cause actual results to differ from those projected. TVA continues to project that the plan will result in a competitive total cost of power in the future. However, the cost of power and amount of debt reduction may differ from the original plan. TVA periodically reviews the plan and will update the underlying assumptions, including changes in market conditions, as necessary, consistent with the plan's objective of achieving competitively priced power by 2007.

In August 1998, the General Accounting Office ("GAO") began a study of TVA's Ten-Year Business Plan at the request of two members of Congress. Among other things, the study will review the assumptions that underlie the plan, measurement and estimating methodologies and specific TVA plans for implementation.

In March 1998, GAO released a report discussing federal power marketing administrations. Although this report did not focus on TVA, an appendix to the report repeated comments regarding

TVA's competitive position that GAO initially made in August 1995 and September 1997 reports. The 1995 report focused on TVA's level of debt, rates, competitive position and deferred nuclear assets. Among other things, this report raised the issue of whether TVA would be able to recover all the costs of its deferred nuclear assets and the financial and competitive impact this would have. The 1997 report discussed the risk of loss to the federal government related to TVA. The report concluded, among other things, that if TVA were required to compete with other electric utilities at a time when wholesale prices are expected to fall, it is reasonably possible that losses to the federal government would occur if the government decided to voluntarily take any actions to prevent default on TVA's debt service requirements, even though TVA's debt is not guaranteed by the federal government. TVA disagrees with a number of GAO's conclusions in the 1995 and 1997 reports. Appendices to the reports contain TVA's views on GAO's conclusions.

In March 1998, GAO released a report entitled "Tennessee Valley Authority: Information on Nonpower Programs". The report, which was requested by Senators Fred Thompson and Bill Frist of Tennessee, analyzes TVA's various nonpower activities and compares them to those performed by four investor-owned utilities ("IOUs") around the country. The GAO report concludes that (1) the selected IOUs do not have nonpower roles and responsibilities that are as comprehensive in nature as TVA's; (2) activities such as flood control and navigation tend to be viewed by TVA, the selected IOUs and other officials as the responsibility of the federal government; (3) TVA's land management responsibilities, especially with regard to the Land Between The Lakes, exceed the selected IOUs' land management activities and (4) the selected IOUs have some programs, such as ones for dam safety, that are similar to nonpower programs operated by TVA.

In November 1997, the Congressional Budget Office (the "CBO") released a study discussing the federal government's role in supplying electricity and possible options for changing that role. Among other things, the study found that the government could save money over the long term by selling many of the facilities it now uses to supply electric power but that the government may want to stay in the electric power business for other reasons. With regard to TVA, the CBO estimated that,

depending on the market value at which TVA could be sold, the government could lose up to \$5.6 billion or gain up to \$2.5 billion by divesting itself of TVA. The study also cites what it terms "financial challenges" that TVA now faces and will face in the near future that could affect its earnings potential and ability to cover its capital obligations.

## **POWER AND ENERGY REQUIREMENTS**

TVA prepares annual forecasts of future power and energy requirements as part of its planning and budgeting process. TVA's forecast procedure involves producing a range of load forecasts for the explicit purpose of bounding the range of uncertainty associated with load growth. TVA produces the load forecasts probabilistically. TVA believes that there is a 90 percent probability that the actual load will be less than the high load forecast, a 50 percent probability that the actual load will be less than medium load forecast and a 10 percent probability that actual load will be less than the low load forecast. TVA's current load forecast through fiscal year 2001 reflects an average annual load growth rate of 4.3 percent, 2.8 percent, and 1.4 percent for the high, medium, and low load forecasts, respectively. TVA's total system energy requirements through fiscal 2001 reflect an average annual growth rate of 3.8 percent, 1.8 percent and (0.1) percent for the high, medium and low load forecasts, respectively. Numerous factors could cause actual results to differ materially from TVA's forecasts.

TVA may enter into electricity futures contracts for the sole purpose of limiting or otherwise hedging TVA's economic risks directly associated with electric power generation, purchases and sales. The Chicago Board of Trade has designated the TVA power transmission system as a hub for electricity futures contracts.

## **POWER SYSTEM**

TVA's power generating facilities at September 30, 1998, included 29 hydroelectric plants, 11 coal-fired plants, 3 nuclear plants, 1 pumped storage hydroelectric plant and 4 combustion turbine plants. Power is delivered to TVA customers over a transmission system of approximately 17,000 miles of lines, including 2,400 miles of extra-high-voltage (500,000 volt) transmission lines. The system interconnects with neighboring power systems at numerous points. TVA has various types of interchange arrangements with these systems. The extent and types of interchange transactions depend



upon the characteristics of the systems' loads, the management policies of the systems and other factors. Interchange arrangements are an essential part of TVA's efforts to minimize investment in electrical facilities, increase the reliability of service, effect operating economies and minimize the cost of electric energy.

During the fiscal year ended September 30, 1998, 62 percent of the power generated by the TVA coordinated system was by fossil fired plants, 28 percent by nuclear, and 10 percent by hydro. Coal consumption during this time was 40.2 million tons. Coal is purchased under contracts ranging from a single delivery to deliveries over several years. TVA coal inventory levels vary from plant to plant based upon a simulated inventory model. As of September 30, 1998, TVA had approximately 27 days' coal supply in inventory at full burn. See

"Nuclear Power Program" — "Nuclear Fuel" for a discussion of TVA's nuclear fuel supplies. Management believes the sources and availability of fuel materials essential to its business should be adequate for the foreseeable future.

TVA's power system is one of the largest in the United States in capacity and in energy production. Its size permitted the construction of large facilities which resulted in lower unit costs. Most of TVA's dams were completed years ago when construction costs were far below present-day levels. Because most of the dams are multipurpose, their cost is shared by navigation, flood control, recreation and local economic development, as well as by power. Thus, each purpose is served at a substantially lower cost than if the dams had been built for a single purpose.

### Generating Resources

The following table summarizes the winter net dependable capacity ("NDC") in megawatts ("MW") on this coordinated system as of September 30, 1998:

	<u>Generating Units</u>	<u>Winter NDC MW (1)</u>
TVA Hydro Plants.....	109	3,236
TAPOCO Hydro Plants .....		318(2)
Corps of Engineers Hydro Plants.....		405(3)
TVA Pumped Storage Facility.....	4	<u>1,532</u>
Total Hydro .....		5,491
Fossil .....	59	15,003
Nuclear .....	5	5,620
Combustion Turbine .....	48	<u>2,384</u>
Total NDC .....		<u>28,498</u>

- (1) NDC as stated is the net power output which can be obtained for a period adequate to satisfy the daily load patterns under expected conditions of operation with equipment in an average state of maintenance. For planning purposes, TVA currently estimates summer dependable total hydro capacity of approximately 5,719 MW; coal-fired capacity of approximately 14,668 MW; nuclear power capacity of approximately 5,534 MW and combustion turbine capacity of approximately 2,029 MW, for a total summer NDC of approximately 27,950 MW.
- (2) Four hydro plants owned by TAPOCO, Inc., a subsidiary of the Aluminum Company of America ("Alcoa"), are operated as part of the TVA power system. Under contractual arrangements with TAPOCO, electric power generated at these facilities is supplied to TVA. In return, TVA supplies electric power for Alcoa's aluminum plant operations located in Tennessee.
- (3) The Corps of Engineers' plants on the Cumberland River system have a total installed capacity of 975 MW, of which 405 MW of NDC is available to TVA under a marketing agreement with the Southeastern Power Administration.

Under arrangements among TVA, the Corps of Engineers (the "CORPS") and the Southeastern Power Administration ("SEPA"), 8 hydro plants

of the CORPS on the Cumberland River system are operated in coordination with the TVA system. These arrangements further provide for capacity

(405 MW) and energy from the Cumberland River system to be supplied to TVA by SEPA at the points of generation and the price paid for the power to be based on the operating and maintenance expenses and amortization of the power facilities. A portion of the output of the Cumberland River system is also made available to SEPA's customers outside the TVA region. The agreement with SEPA covering these arrangements for power from the Cumberland River system can be terminated upon three years' notice. This notice may be given beginning June 30, 2017.

TVA has contracted with Choctaw Generation, Inc. to purchase and take delivery of up to 440 MW of power over a 30-year term from a lignite power plant to be constructed in Mississippi, contingent upon satisfactory completion of all necessary environmental reviews. Commercial operation of the plant is currently scheduled for January 2001. The owner of the facility bears the construction and operating risks. If the owner fails to deliver the required energy, the owner will be responsible for securing replacement power for TVA at the contractually agreed price.

TVA plans to install additional peaking capacity at one or more of its fossil plants. By the summer of 2000, TVA intends to install eight natural-gas combustion turbines, pending environmental and technical review of the installation locations. TVA is considering its Gallatin, Johnsonville and Colbert fossil plants, all of which have existing combustion turbines, as sites for these new turbines. TVA is also negotiating a contract to install four additional natural-gas combustion turbines in 2001.

### **Integrated Resource Plan**

In December 1995, the Board approved TVA's Integrated Resource Plan ("IRP") that presents TVA's strategy for meeting future customer energy demands. The IRP identifies a 25-year least-cost energy resource strategy for TVA's power system. TVA's IRP strategy relies on a portfolio of energy resource options that made up the best strategies evaluated for the TVA power system. These strategies performed well across all of the IRP evaluation criteria, including debt, rates, costs, reliability and environmental impacts and regulations. These strategies are designed to enable TVA to respond to future demands in a manner that maintains flexibil-

ity and enhances its competitive position. Included in the portfolio are customer service options such as energy conservation and load management; supply side options, including power purchased from other producers; and investigation and use of renewable energy.

Since the IRP was issued in December 1995, TVA has undertaken the following actions identified in the IRP.

1. Purchased options on the future delivery of peak capacity that can be exercised in varying amounts from season-to-season to meet future changing power needs in the Tennessee Valley region.

2. Issued an Environmental Impact Statement evaluating the conversion of Bellefonte Nuclear Plant to a fossil fuel-fired plant. A feasibility study performed by an outside team of technical and financial experts concluded that one of the most economical fossil conversion strategies was to complete Bellefonte as a natural gas-fired combined-cycle plant. See "Nuclear Power Program" — "Status of Certain Nuclear Plants".

3. Began, implemented or expanded energy service programs in the following market segments:

- Expanded the traditional residential efficiency programs, such as the heat pump retrofit program, new homes construction program (with a Home Energy Rating System) and energy efficient new manufactured homes program (with energy efficient heat pumps).
- Implemented new residential conservation programs such as a residential self-audit program, a student home energy audit program and a low income program.
- Expanded energy services activities to provide energy efficiency recommendations to and financing options for commercial and industrial customers throughout the Tennessee Valley.
- Continued traditional load management activities, including water heater control, and began a pilot program with residential and commercial customers to monitor and control hourly energy usage via computer software.

4. Continued research into several renewable energy technologies such as wind, biomass, solar and landfill methane.

TVA continues to review and update its resource plans. To date, several internal options have been approved, including upgrades to combustion turbine units, modernization of the hydro system and fossil plant improvements. Discussions with suppliers of peaking power are underway to determine if other options should be pursued.

#### Year 2000 Readiness

The "Year 2000" issue concerns the inability of information technology systems to properly recognize and process date-sensitive information related to the year 2000 and beyond. TVA's operations are extensively computerized and are also dependent on the information technology systems of others with which it does business and interfaces. Thus, the failure by TVA or others with which it does business and interfaces to become Year 2000 compliant on a timely basis could have a material adverse effect on, among other things, TVA's results of operations, liquidity and financial condition and its generation and transmission operations. Specific risks to TVA associated with the Year 2000 issue include, among other things, power production and delivery interruptions and administrative and accounting system malfunctions.

TVA is taking steps to address the impact of the Year 2000 issue on its information technology systems and other systems that may be affected by this issue. TVA's efforts in this regard have focused on six areas: (1) computer hardware and equipment, (2) application software, (3) systems software, (4) embedded controls, (5) facilities and (6) telecommunications. For each of these six areas, TVA is (1) developing a Year 2000 remediation strategy, (2) inventorying and assessing the priority of items that may be affected by the Year 2000 issue, (3) replacing, repairing or converting items that are not Year 2000 ready, (4) testing and validating the Year 2000 readiness of replaced, repaired and converted items and (5) implementing the use of replaced, repaired and converted items.

For each of the six areas described above, TVA has (1) developed a Year 2000 remediation strategy, (2) completed both its initial inventory and the majority of its priority assessments of mission-critical items and (3) completed a substantial portion of its remediation, testing and implementation

activities for mission-critical items. As of December 31, 1998, TVA's remediation, testing and implementation activities relating to mission-critical items for the following five of these six areas (each area except embedded controls) were complete to the following extent:

<u>Area of Focus</u>	<u>Percentage Complete</u>
Computer Hardware and Equipment . .	100
Application Software . . . . .	31
Systems Software . . . . .	100
Facilities . . . . .	98
Telecommunications . . . . .	98

Except for certain activities that are scheduled to be completed throughout 1999 to minimize disruption of operations, TVA expects to complete its remediation, testing and implementation activities relating to mission-critical items for these five areas by March 1999.

With respect to embedded controls, TVA's remediation, testing and implementation activities have focused on controls that affect (1) nuclear operations, (2) fossil operations, (3) hydro operations and (4) transmission and power supply operations. As of December 31, 1998, TVA's remediation, testing and implementation activities for embedded controls critical to these four areas were complete to the following extent and are expected to be entirely completed on the following dates:

<u>Area Affected by Embedded Controls</u>	<u>Percentage Complete</u>	<u>Expected Date of Final Completion</u>
Nuclear Operations	53	July 1999
Fossil Operations	43	November 1999
Hydro Operations	92	January 1999
Transmission and Power Supply Operations	43	May 1999

The Nuclear Regulatory Commission (the "NRC") has notified all utilities operating nuclear power plants that they are required to inform the NRC of steps they are taking to ensure that their computer systems will function properly by the year 2000. Specifically, the NRC has required each such utility to submit a written indication of, among other things, whether it is pursuing a plan to solve its Year 2000 problems similar to the plan outlined in *Nuclear Utility Year 2000 Readiness*, a publication of the Nuclear Energy Institute and Nuclear Utilities Software Management Group. TVA sub-

mitted its required response on July 22, 1998, indicating that it has pursued and is continuing to pursue a Year 2000 readiness program similar to that recommended in *Nuclear Utility Year 2000 Readiness*. The NRC has also required each such utility to submit a written response, not later than July 1, 1999, that either confirms that its plants are Year 2000 ready or provides a status report of work remaining to be done.

In addition to remedying its own Year 2000 issues, TVA has been communicating with suppliers, distributors, financial institutions and others with which it does business and interfaces in an effort to assess the Year 2000 compliance efforts of such entities and to share information regarding TVA's Year 2000 compliance efforts. As of December 31, 1998, TVA's assessment of the Year 2000 efforts of entities whose Year 2000 readiness is critical to TVA's operations was approximately 79 percent complete. TVA expects to complete this assessment by June 30, 1999. TVA expresses no views about the adequacy of the Year 2000 efforts of those entities with which it does business and interfaces. However, TVA will take the results of its assessment of these entities' efforts into account in developing its Year 2000 contingency plans.

TVA is in the early stages of developing contingency plans to address system failures that may result from Year 2000 problems. Additionally, consistent with the General Accounting Office document titled *Year 2000 Computing Crisis: Business Continuity and Contingency Planning*, TVA has developed a business partnership program that includes elements for business continuity and contingency planning.

Although it is difficult to accurately estimate the cost of TVA's Year 2000 work, TVA believes that it is allocating sufficient resources to address the Year 2000 issue and does not expect such costs to be material to its financial position and operations. TVA estimates the projected direct and indirect costs of its Year 2000 work to be approximately \$38 million. As of December 31, 1998, TVA had expended approximately \$20 million of this amount.

## **NUCLEAR POWER PROGRAM**

### **Overview**

TVA has five operating nuclear units at three locations: Sequoyah Units One and Two, Browns

Ferry Units Two and Three and Watts Bar Unit One. Construction activities at three additional units have been suspended. One licensed unit remains in an inoperative status. See detailed discussions on all operating and inoperative nuclear units in the sections below and note 2 of the accompanying Financial Statements.

### **Sequoyah**

Sequoyah is a two-unit plant located approximately 7.5 miles northeast of the city limits of Chattanooga, Tennessee, with pressurized water reactors supplied by Westinghouse Electric Corporation. Unit One is rated at 1,147 MW net electrical output. Unit Two is rated at 1,142 MW net electrical output. TVA received an Operating License for Unit One in 1980, and the unit began commercial operation in 1981. TVA received an Operating License for Unit Two in 1981, and the unit began commercial operation in 1982. The Operating Licenses for these units expire 40 years after issuance. TVA designed, built and operates the plant. TVA voluntarily shut down both units in 1985 in response to technical and operational concerns.

Both Sequoyah units returned to commercial operation in 1988. The NRC removed both units from its list of plants that require close monitoring in 1989. Sequoyah Units One and Two have recorded an 85.9 average percent equivalent availability for a three year period ending September 1998. The "equivalent availability" is the ratio of the energy a unit could have generated, if called on, to the energy the unit would have produced if it had run at full load over the entire period measured, expressed as a percentage.

### **Browns Ferry**

Browns Ferry is a three-unit plant located approximately 10 miles southwest of Athens, Alabama, with boiling water reactors supplied by General Electric Company. Each unit was originally rated at 1,065 MW net electrical output. However, Unit Three was uprated 5% during the cycle 8 refueling outage resulting in 1118 net electrical output as of October 15, 1998. TVA anticipates that Unit Two will be uprated after the refueling outage in May 1999. TVA designed, built and operates the plant. TVA received Operating Licenses for Units One, Two and Three in 1973, 1974 and 1976, respectively. These units began commercial operation in 1974, 1975 and 1977, respectively. The



Operating Licenses for these units expire 40 years after issuance. TVA voluntarily shut down Units One, Two and Three in 1985 in response to technical and operational concerns.

Browns Ferry Unit Two returned to commercial operation in 1991. The NRC removed it from its list of plants requiring continued close monitoring in 1992. Browns Ferry Unit Two has recorded a 91.3 average percent equivalent availability factor for a three year period ending September 1998.

TVA restarted Browns Ferry Unit Three in November 1995, and the unit returned to commercial operation in January 1996. In June 1996, the NRC removed Browns Ferry Unit Three from its list of plants warranting close monitoring. Browns Ferry Unit Three recorded an 89.7 percent equivalent availability factor from restart through September 30, 1998.

Browns Ferry Unit One has been idled since March 1985. Major modifications would be required to bring the plant to current standards. At September 30, 1998 the undepreciated cost of Browns Ferry Unit One was \$73 million. In 1994, preliminary cost estimates based on IRP information indicated that cost associated with returning Unit One to service would have been between \$1.2 and \$3.2 billion. See "Status of Certain Nuclear Units" for a further discussion of the status of Browns Ferry Unit One.

### **Watts Bar**

Watts Bar is a two-unit plant located approximately 50 miles northeast of Chattanooga, Tennessee, with pressurized water reactors supplied by Westinghouse Electric Corporation. Unit One is rated at 1,158 MW net electrical output. TVA designed and built the plant to its present level of completion. The Construction Permit for Unit Two expires in December 1999.

Although physical construction of Watts Bar Unit One was substantially complete in 1985, efforts to obtain an Operating License were delayed due to numerous safety concerns. Overall plant design was reverified, and extensive modifications were made. The NRC granted TVA a license to operate Unit One at up to five percent of rated power in November 1995 and at full power in February 1996. Watts Bar Unit One commenced full power commercial operation in May 1996. The Operating License for Unit One expires 40 years after issuance.

Since beginning commercial operation, the plant has operated at an 86.4 percent equivalent availability factor through September 30, 1998.

In 1988, TVA suspended construction activities at Watts Bar Unit Two because of a reduction in the forecasted load growth. Total investment in Unit Two at September 30, 1998, was \$1.7 billion, including capitalized interest. In 1994, preliminary cost estimates based on IRP information indicated that the cost associated with completing Unit Two would have been between \$1.1 and \$2.9 billion. See "Status of Certain Nuclear Units" for a further discussion of the status of Unit Two.

### **Bellefonte**

Bellefonte is a two-unit power plant located approximately 59 miles southwest of Chattanooga, Tennessee. Each unit has a pressurized water reactor supplied by Babcock & Wilcox Company rated at 1,212 MW net electrical output. TVA designed and built the plant to its present level of completion. Construction Permits were obtained from the NRC for both units in December 1974.

TVA deferred construction activities on Bellefonte Unit Two because of a reduction in forecasted load growth in October 1985. TVA deferred construction activity on Unit One in July 1988. In March 1993, TVA notified the NRC of its plans to resume completion activities at Bellefonte, but no construction activities have occurred since 1988. Construction Permits for Unit One and Unit Two have been extended by the NRC to 2001 and 2004, respectively.

As of September 30, 1998, TVA had \$4.6 billion, including capitalized interest, invested in these units. See "Status of Certain Nuclear Units" for discussion of Bellefonte's current status. In 1994, preliminary cost estimates based on IRP information indicated that cost associated with completing the Bellefonte units would have been between \$1.3 and \$3.5 billion for Unit One and \$900 million and \$2.4 billion for Unit Two.

### **Status of Certain Nuclear Units**

Preliminary cost estimates, utilizing the IRP (see "Power System" — "Integrated Resource Plan"), showed that completing the units at Bellefonte and Watts Bar Unit Two may not be economically feasible. Consequently, in December 1994 the Board announced a major change in policy

declaring that TVA will not, by itself, complete Bellefonte Units One and Two and Watts Bar Unit Two as nuclear units. Additionally, the Board decided that Browns Ferry Unit One would continue in its inoperative status.

TVA's IRP identified as a viable option the conversion of the Bellefonte facility to a combined-cycle plant utilizing natural gas or gasified coal. In 1997, an independent team of technical and financial experts completed a feasibility study to evaluate options for the conversion of Bellefonte Nuclear Plant to a fossil fuel-fired plant. The feasibility study indicates that one of the most economical fossil conversion strategies is to complete Bellefonte as a natural gas-fired combined-cycle plant. TVA also issued an Environmental Impact Statement ("EIS") assessing the environmental impacts of various fossil conversion options. The EIS identified the natural gas-fired combined-cycle plant alternative as the preferred option. Additionally, TVA submitted a proposal to DOE to complete Bellefonte as a nuclear plant and to operate it to produce tritium for DOE in addition to electricity. TVA also proposed providing irradiation services to produce tritium at Watts Bar Nuclear Plant, with backup and surge capability using one unit at Sequoyah Nuclear Plant. In December 1998, DOE and TVA agreed to begin negotiating a contract for TVA to produce tritium for DOE, as needed and at cost, at one or more operating reactors designated by TVA. TVA's Watts Bar and Sequoyah plants are the possible sites for tritium production.

At September 30, 1998, TVA's total investment in Bellefonte Units One and Two, Watts Bar Unit Two and Browns Ferry Unit One was \$6.4 billion. TVA's future decisions regarding these units will ultimately impact the method of cost recovery. The Board has determined that it will establish rate adjustments and operating policies to ensure full recovery of the cost of these units and compliance with the requirements of the TVA Act.

Because of extensive regulatory requirements and resulting delays which are often very lengthy, estimates of the cost to complete nuclear plants have typically been unreliable. No assurance can be given that TVA's cost estimates would not change significantly if a decision were made to complete or operate any of TVA's inoperative units.

## **Nuclear Fuel**

TVA owns all nuclear fuel held for its operating and deferred nuclear units. The net book value of this fuel was \$727 million as of September 30, 1998. Effective October 1, 1998, TVA reclassified \$332 million from nuclear fuel inventory to deferred charges. See notes 1 and 2 of the accompanying Financial Statements. The excess uranium inventory TVA accumulated during the late 1980's and early 1990's as a result of the extended regulatory shutdown of TVA's nuclear units has been utilized. TVA will fill future uranium requirements by a combination of term and spot purchase contracts while maintaining diversity of supply source. TVA currently has approximately 65 percent of its forward 5-year (1999-2003) uranium requirements either in inventory or under contract. TVA generally fills conversion, enrichment, and fabrication services needs on a requirements basis under term contracts.

TVA's investment in the fuel being used in the Sequoyah, Watts Bar and Browns Ferry units is being amortized and accounted for as a fuel expense. The Bellefonte initial cores have been defabricated, and uranium from these cores has been used in the Sequoyah and Browns Ferry units with the net book value assigned accordingly.

## **Nuclear Waste**

### *Spent Nuclear Fuel*

The Nuclear Waste Policy Act of 1982 (the "NWPAct") gives the federal government the responsibility for the permanent disposal of spent nuclear fuel but gives each nuclear power system the responsibility for the cost of permanent disposal. The NWPAct requires each nuclear power system to enter into a disposal contract with DOE for spent nuclear fuel. This contract requires each nuclear power system to pay a fee that is currently one mill per kWh for the net electricity generated by each of its reactors and sold. Although it is uncertain when DOE will be able to begin accepting spent nuclear fuel, TVA believes its spent fuel efforts will ensure that sufficient at-reactor storage is available to meet all of TVA's spent fuel storage requirements until DOE is prepared to accept TVA's spent fuel.

TVA presently has the capability to store its spent fuel at Sequoyah through the year 2004, at Browns Ferry Units One and Two through the year 2011 and at Browns Ferry Unit Three through the



year 2000. Based on a one unit operation, TVA has the capability to store its spent fuel at Watts Bar to 2018. TVA has a project underway to extend storage capacity at Browns Ferry Unit Three to 2006.

TVA plans to extend storage capability through life-of-plant if necessary by using higher density racks in its existing storage pools or dry storage casks. Additional storage capacity increases will require NRC approval. However, all of the above methods of extending storage capability have been licensed by the NRC at other facilities.

#### *Low-Level Radioactive Waste*

Disposal costs for low-level radioactive waste that result from normal operation of nuclear units have increased significantly in recent years. Pursuant to the Low-Level Radioactive Waste Policy Act, each state is responsible for disposal of low-level waste generated in that state. States may form regional compacts to jointly fulfill their disposal responsibilities. The States of Tennessee and Alabama (where TVA's nuclear plants are located) have joined with other southeastern states to form the Southeast Compact Commission for Low-Level Radioactive Waste Management. This commission regulates the siting of new disposal facilities and the disposal of low-level waste within the southeastern states.

Until July 1995, the low-level waste generators located in the southeastern states were required to dispose of their waste at the Barnwell, South Carolina disposal facility. South Carolina withdrew from the Southeast Compact Commission in order to open the Barnwell facility to all states except North Carolina. The states participating in the Southeast Compact Commission have selected North Carolina as the host state to select, license and construct a new disposal site. Because of funding and licensability issues, TVA currently uses the Barnwell facility for high activity waste disposal and the Envirocare of Utah facility for low activity waste disposal. If off-site storage were to become unavailable, TVA would have the option of storing its low-level radioactive waste in on-site facilities at TVA's nuclear plants. These facilities are sized to handle the anticipated storage needs for the foreseeable life of the plants.

#### **Nuclear Insurance**

In 1988, Congress extended the indemnification and limitation of liability plan afforded the

United States nuclear industry by the Price-Anderson Act for an additional 15 years. Certain provisions of the Price-Anderson Act are now due to expire on August 1, 2002. Under the Price-Anderson Act, the limit of liability from an accident at an NRC-licensed reactor is approximately \$9.6 billion (\$88 million for each of the NRC-licensed reactors in the United States), composed of primary and secondary layers of financial protection. This amount is periodically adjusted for inflation. For further information about this nuclear liability insurance and its deferred premium, see note 9 of the accompanying Financial Statements. In accordance with industry practice, TVA maintains certain liability insurance coverage for workers at its nuclear sites.

NRC regulations require nuclear power plant licensees to obtain, and TVA has acquired, onsite property damage insurance coverage of \$1.06 billion per nuclear site. Some of the nuclear property insurance may require the payment of retrospective premiums of up to approximately \$22.0 million (the retrospective premium amount as of November 1998) in the event that losses by another insured party or TVA exceed available funds. In accordance with NRC regulations, the proceeds of nuclear property insurance are first used to ensure that the reactor is in safe and stable condition and that it can be maintained in a condition that prevents significant risk to the public. Next, the proceeds are used for decontamination or, if necessary, decommissioning the reactor. Any excess proceeds insure against casualties to property.

#### **Decommissioning**

In prior years, TVA charged the excess of the annual decommissioning provision over earnings from any investments designated for funding decommissioning costs to depreciation expense. TVA made investments in amounts sufficient to fully fund all estimated decommissioning costs. Beginning in fiscal 1998, TVA changed its method of accounting for decommissioning costs and related liabilities. TVA now recognizes, as incurred, all obligations related to closure and removal of its nuclear units. TVA measures the liability for closure at the present value of the estimated cash flows required to satisfy the related obligation and discounted at a determined risk-free rate of interest. The corresponding charge to recognize the additional obligation was effected through the creation

of a regulatory asset. TVA further modified its method of accounting for decommissioning costs such that earnings from decommissioning fund investments, amortization expense of the decommissioning regulatory asset and interest expense on the decommissioning liability are deferred in accordance with Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation". The book value of TVA's decommissioning fund investments was \$571 million at September 30, 1998. See notes 1 and 9 of the accompanying Financial Statements.

## ENVIRONMENTAL MATTERS

TVA's activities are subject to various federal, state and local environmental statutes and regulations. Major areas of regulation affecting TVA's activities include air pollution control, water pollution control, and management and disposal of solid and hazardous wastes. Because TVA is a federal agency, it is subject only to those state and local environmental requirements for which Congress has clearly waived federal agency immunity. Respecting the major environmental areas (air, water and waste), limited waivers have been enacted by Congress. TVA's activities may also be subject to other narrower environmental requirements or to environmental requirements that affect only federal activities.

TVA has incurred and continues to incur substantial capital expenditures and operating expenses to comply with environmental requirements. See note 9 of the accompanying Financial Statements. Because these requirements change frequently, the total amount of these costs is not now determinable. It is anticipated that environmental requirements will become more stringent and that compliance costs will increase, perhaps by substantial amounts.

### Air Pollution

Under the Clean Air Act, the Environmental Protection Agency ("EPA") has promulgated national ambient air quality standards for certain air pollutants, including sulfur dioxide, particulate matter and nitrogen oxide. Coal-fired generating units such as TVA's are major sources of these pollutants. TVA also operates other facilities that are smaller sources of these pollutants. The States of Alabama and Tennessee and the Commonwealth of Kentucky have promulgated implementation plans

that regulate sources of air pollution within their boundaries, including TVA sources, in order to achieve and maintain the national ambient standards. TVA has installed air pollution control equipment and employs strategies to comply with applicable state-established emission limitations.

The acid rain control provisions of the 1990 Amendments to the Clean Air Act establish a number of new requirements for utilities. EPA and states are implementing these requirements in two phases. Through 1998, TVA had invested approximately \$860 million in capital for Phase 1 and Phase 2 compliance. TVA estimates it will spend an additional \$300 million in capital through 2003 to finalize the Phase 2 compliance measures.

During 1998, TVA unveiled a new clean air strategy that will reduce nitrogen oxide emissions from its coal fired plants by 168,000 tons per year by 2003. The installation of new equipment will improve local and regional air quality and allow Tennessee Valley states greater flexibility for industrial and economic growth in the region. These new measures focus on reducing local and regional ozone concentrations to levels needed to avoid violating the new, more stringent ozone standard established by EPA last year.

TVA's new nitrogen oxide reduction strategy is consistent with the type of controls that would be needed to comply with EPA's mandated revisions to State Implementation Plans for reduction of ozone transport. However, the strategy will not by itself bring TVA into compliance with expected revisions to state plans, depending on the level of generation from TVA's coal-fired units. TVA will install equipment in its Allen, Cumberland, Bull Run, Paradise and Widows Creek fossil plants that breaks down nitrogen oxide into nitrogen and water. TVA expects this equipment to be in place by 2003. The cost of implementing this strategy will be between \$500 million and \$600 million, in addition to amounts that TVA has already spent to comply with the 1990 Clean Air Act Amendments. The new reduction strategy, together with controls that TVA is already implementing, will reduce nitrogen oxide emissions more than 70 percent. TVA is investigating what additional steps it may have to take to meet EPA ozone transport reduction requirements.

EPA has finalized new, more stringent particulate matter standards and has proposed rules to reduce regional haze. These actions may require

TVA to make additional reductions of sulfur dioxide emissions beyond those currently planned. TVA anticipates that compliance with the new regulations will be required around 2009.

TVA cannot with certainty determine the costs for additional reductions of nitrogen oxide, sulfur dioxide and particulate matter emissions beyond those required by the acid rain provisions of the 1990 Clean Air Act Amendments. However, the costs for these additional reductions could exceed \$2.5 billion.

EPA is investigating whether coal-fired utilities in the eastern U.S., including TVA, may have modified their coal-fired boilers without complying with new source programs. The outcome of this investigation is uncertain.

The Clinton Administration signed the Kyoto Protocol to the United Nations Framework Convention on Climate Change in November 1998. If ratified by the Senate, the protocol would require the United States to reduce its annual greenhouse gas emissions (including carbon dioxide) around 2008 to 2012 to a level seven percent below 1990 emission levels. Such a national requirement would likely require electric utilities to achieve similar reductions. The costs to utilities to achieve these reductions could be substantial.

### **Water Pollution**

Under the Clean Water Act, every point source which discharges pollutants into waters of the United States must obtain a National Pollutant Discharge Elimination System ("NPDES") permit specifying the allowable quantity and characteristics of the pollutants discharged. TVA's various point sources have received NPDES permits, including all of its major generating units. Compliance with NPDES requirements has necessitated substantial expenditures and may require additional, substantial expenditures in the future as NPDES permits come up for renewal and applicable requirements become more stringent.

The Clean Water Act allows the permitting authority to establish thermal limits less stringent than the water quality criteria if the discharger can demonstrate that the alternate limit will assure protection and propagation of a balanced, indigenous aquatic population. TVA has now been issued alternate limits at several of its facilities, and it is meeting these limits. EPA has underway a

rulemaking that would address the design of water intakes. The rulemaking is not expected to be completed for several years but could require changes to be made at TVA facilities. The cost of such changes is uncertain.

### **Solid and Hazardous Waste Management**

Under the Resource Conservation and Recovery Act ("RCRA"), the storage, transportation and disposal of hazardous wastes are regulated by EPA and the states. RCRA also allows EPA and the states to regulate solid wastes, and the states have detailed permitting programs for this. TVA has detailed procedures in place designed to ensure compliance with all applicable requirements for the management of hazardous wastes. Additionally, TVA has instituted an approved supplier list for hazardous waste disposal contractors under which such contractors' financial status, compliance history and physical facilities and operations can be reviewed before they are allowed to treat or dispose of any of the hazardous wastes generated by TVA facilities. TVA does not itself operate any hazardous waste disposal or treatment facilities but does operate a permitted hazardous waste storage facility in Muscle Shoals, Alabama. TVA maintains solid waste disposal permits for the solid waste disposal areas (e.g., fly ash, scrubber sludge, demolition materials and asbestos) it operates at some of its plant sites. TVA's costs in this area have not been substantial, but applicable requirements change frequently and are expected to become more stringent.

Under the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA"), the release and cleanup of hazardous substances are regulated. Certain persons associated with the release of hazardous substances to the environment can be held responsible for their cleanup, regardless of when the substances were released or when the specific person may have been associated with the substance. This liability under CERCLA is generally viewed as joint and several. In a manner similar to other industries and power systems, TVA has generated or used hazardous substances over the years. In connection with these activities, TVA has been identified as a potentially responsible party or received EPA information requests related to five non-TVA sites at which TVA hazardous substances may have been disposed. Based on pending settlement negotiations at

three of the sites and the relatively small amount of TVA materials allegedly sent to any of them, TVA's potential liabilities for its share of cleanup costs at these sites are estimated to be less than \$200,000.

### **Miscellaneous**

Polychlorinated biphenyls ("PCBs") have been widely used as insulating fluids in electric equipment such as transformers and capacitors. Use of this equipment and the cleanup of released PCBs are regulated by EPA under the Toxic Substances Control Act. The TVA power system uses thousands of pieces of equipment that contain some level of PCBs. This equipment, when maintained properly, may continue to be operated under TVA's PCB regulations for the remainder of its useful lives. However, TVA is phasing out much of this equipment as a matter of policy. The cost of phasing out the remainder of this equipment should not exceed \$40 million (for equipment replacement and disposal costs) but cannot be accurately determined at this time. TVA has detailed procedures in place to conform its operations to EPA's PCB regulations and has not incurred substantial costs in this area.

The National Emissions Standard for Hazardous Air Pollutants (NESHAP) defines the environmental protection requirements for the management of asbestos. Many of TVA's facilities were constructed at a time when asbestos was the insulation of choice by industry. Special handling and disposal are required when asbestos materials are removed. Although not required to do so, TVA is removing or encapsulating asbestos as appropriate.

There is public concern about whether there are adverse health effects from exposure to electric

and magnetic fields ("EMF"). There are many sources of EMF, including electric transmission lines. Certain research, including a report by a National Academy of Sciences organization, has not found conclusive evidence that EMF causes adverse health effects. Other research, such as a report by the National Institute of Environmental Health Sciences, has found limited evidence that certain types of exposure to EMF are carcinogenic. Research in this area continues. Substantial costs could be incurred by electric systems, including TVA, if EMF levels from transmission lines have to be reduced, but this appears unlikely at this time.

As a federal agency, TVA is required to consider the potential environmental effects of major federal actions affecting the quality of the human environment under the National Environmental Policy Act (the "NEPA") and implementing regulations and to make these evaluations available to the public. TVA has incorporated the NEPA review process into its decision making process. NEPA-related costs are incurred continuously but not in substantial amounts.

### **INSURANCE**

TVA does not generally carry property damage or public liability insurance except (1) as may be required or appropriate with respect to nuclear facilities and (2) to the extent it may do so as part of an owner-controlled insurance program it has implemented for some large contracts requiring on-site labor. The Federal Employees' Compensation Act governs liability for service-connected injuries to employees. See "Nuclear Power Program" — "Nuclear Insurance" herein and note 9 of the accompanying Financial Statements for additional information with respect to insurance.



## MANAGEMENT

TVA is administered by a board of directors composed of three persons appointed by the President and confirmed by the Senate. The Board and selected officers, their ages, their years of employment with TVA and principal occupations for recent years are as follows:

<u>Name and Title</u>	<u>Age</u>	<u>Year Commenced Employment</u>	<u>Year Term Expires</u>
Craven Crowell . . . . . Chairman	55	1993	2002
William H. Kennoy . . . . . Director	62	1991	1999
Oswald J. Zeringue . . . . . President and Chief Operating Officer	53	1989	
John A. Scalice . . . . . Chief Nuclear Officer & Executive Vice President, TVA Nuclear	51	1989	
David N. Smith . . . . . Chief Financial Officer & Executive Vice President, Financial Services	55	1995	
Norman A. Zigrossi . . . . . Chief Administrative Officer & Executive Vice President, Business Services	63	1986	
Edward S. Christenbury . . . . . General Counsel and Secretary	57	1987	

Mr. Crowell was appointed to the Board in July 1993. Prior to his current position, he served as Chief of Staff for Jim Sasser, Tennessee's then senior U.S. Senator (1989-1993), as Vice President of TVA's Office of Governmental & Public Affairs (1988-1989) and as TVA's Director of Information (1980-1988).

Mr. Kennoy was appointed to the Board in April 1991. Prior to his current position, he served as President of Kennoy Engineers for twenty-five years.

The third board position was occupied by Johnny H. Hayes until he resigned from the Board effective January 29, 1999. This position is currently vacant.

Mr. Zeringue was named President and Chief Operating Officer in April 1998. Prior to his current position, he served as Chief Nuclear Officer & Executive Vice President (1997-1998), as Senior Vice President, Nuclear Operations (1993-1997), as Browns Ferry Site Vice President (1989-1993) and as Plant Manager of Palo Verde Nuclear Station, Arizona Public Service Company (1987-1989).

Mr. Scalice was named Chief Nuclear Officer & Executive Vice President, TVA Nuclear in June 1998. Prior to his current position, he served as Acting Chief Nuclear Officer (beginning April

1998), as Senior Vice President of Nuclear Operations (1997-1998), as Watts Bar Site Vice President (1993-1997), as Plant Manager of Browns Ferry Nuclear Plant (1991-1993), as Plant Manager of Watts Bar Nuclear Plant (1989-1991) and as Plant Manager of Shoreham Nuclear Power Station, Long Island Lighting Company (1989).

Mr. Smith was named Chief Financial Officer in January 1995 and additionally was named Executive Vice President, Financial Services, in October 1996. Prior to his current position, he served as Executive Director of Odyssey Financial (1993-1994), as Vice President of Finance of LTV Corporation (1991-1993) and as Assistant Treasurer and Director of Corporate Finance of LTV Corporation (1986-1991).

Mr. Zigrossi was named Chief Administrative Officer in February 1994 and additionally was named Executive Vice President, Business Services, in October 1996. Prior to his current position, he served as TVA's President, Resource Group (1992-1994) and as TVA's Inspector General (1986-1992).

Mr. Christenbury assumed the position of General Counsel of TVA in January 1987. Prior to his current position, he served as an Assistant General Counsel at the NRC (1980-1987).

## EMPLOYEES

On December 31, 1998, TVA had about 13,830 employees, of which approximately 5,160 were trades and labor employees. Neither the federal labor relations laws covering most private sector employers nor those covering most federal agencies apply to TVA. However, the Board has a long-standing policy of recognizing and dealing with recognized representatives of its employees. Federal law prohibits TVA employees from engaging in strikes against TVA.

TVA has entered into separate long-term recognition agreements with the Tennessee Valley Trades and Labor Annual Council ("Annual Council"), the International Brotherhood of Teamsters ("Teamsters"), and four unions that represent TVA's salary policy (white collar) employees (collectively, the "Salary Policy Unions"). These agreements typically provide for negotiation of most provisions except monetary matters about every three years. Wage and salary and benefit negotiations or adjustments generally occur annually. Unresolved disputes over rates of pay for trades and labor employees are resolved by binding decisions of the Secretary of Labor. Pay and monetary benefits disputes for other represented employees are resolved through binding arbitration. The recognition agreements with the Annual Council and the Teamsters recognize these entities or their successors through 2007. The agreements with the Salary Policy Unions recognize these entities or their successors through 2012.

TVA currently has separate collective bargaining agreements in place with the Teamsters, the Annual Council and each of the Salary Policy Unions. With the expiration of parts of the collective bargaining agreement between TVA and the Annual Council in December 1997, TVA exercised its right to give a 90-day notice to reopen the remainder of the agreement with the Annual Council and potentially to cancel the agreement. In April 1998, negotiations pursuant to this reopener ended in impasse. To date, TVA has not exercised its right to cancel the agreement, and there is a pending lawsuit by the Annual Council against TVA in which the Annual Council claims that TVA cannot cancel the agreement at this time. Additionally, TVA has notified the Annual Council that a dispute exists concerning the employees who constitute an appropriate bargaining unit. Following a hearing on this matter, TVA issued a decision

finding that one bargaining unit is appropriate for its power organizations and that another bargaining unit is appropriate for trades and labor work within two other organizations. These two units would replace the six separate bargaining units that represent trades and labor employees covered by the TVA-Annual Council agreement. The Annual Council's position is that no bargaining unit dispute exists. Under the collective bargaining agreement, bargaining unit disputes may be appealed to arbitration. TVA and the Annual Council are again conducting negotiations on a new collective bargaining agreement covering annual trades and labor employees. TVA has advised the Annual Council that it will hold any further action on the bargaining unit issue in abeyance during these negotiations.

Salaries of regular TVA employees are limited by a federal pay cap (Executive Level IV, currently \$118,400). The pay cap has made it difficult in the past for TVA to recruit and retain top management talent, and TVA continues to face this issue. Increases in the pay cap since January 1990 from \$80,700 to \$118,400 have somewhat alleviated the impact of the pay cap on TVA. TVA has also addressed this issue by developing and implementing supplementary compensation arrangements, which have substantially reduced the impact of the pay cap. TVA believes the implementation of these arrangements is within its legal authority. GAO has expressed the opinion that some of these arrangements are not within TVA's legal authority. However, GAO has no authority to issue binding legal opinions on this matter or to stop any TVA payments. Congress is aware of TVA's supplemental compensation arrangements and has not taken any action that would undermine TVA's position that the arrangements are within its legal authority. TVA has contracted with a national compensation management firm to determine whether TVA's executive compensation arrangements are appropriate to attract and retain the caliber of executive talent required to manage TVA's power system.

In October 1995, the President issued an Executive Order requiring government corporations, including TVA, to submit information to the Office of Management and Budget ("OMB") on bonuses paid to its senior executives. Those bonuses and the information supporting them were last reported to OMB in December 1998 and were also publicly disseminated. OMB approval of TVA's bonuses is not required.



## CERTAIN PROVISIONS OF THE TENNESSEE VALLEY AUTHORITY ACT

*The following summary of certain provisions of the Act is **not complete** and is qualified in its entirety by reference to the full text of the Act.*

### Payments in Lieu of Taxes

TVA is not subject to federal income taxes or to taxation by states or their subdivisions. However, the Act requires TVA to make payments in lieu of taxes to states and counties in which the Corporation conducts power operations. The basic amount of these payments is 5 percent of gross revenues from the sale of power to entities other than federal agencies during the preceding year, with a provision for minimum payments under certain circumstances.

### Payments to the Treasury

The Act requires TVA to make certain payments to the Treasury each year from Net Power Proceeds in excess of those required for debt service, as a return on and reduction of the Appropriation Investment. The Appropriation Investment totaled \$568 million as of September 30, 1998. Net Power Proceeds are defined as the remainder of gross power revenues from TVA's power program

*after deducting*

- the costs of operating, maintaining and administering its power properties (including multiple-purpose properties in the proportion that multiple-purpose costs are allocated to power) and
- payments to states and counties in lieu of taxes,

*but before deducting*

- depreciation accruals or other charges representing the amortization of capital expenditures,

*plus*

- the net proceeds of the sale or other disposition of any interest in TVA's power properties that constitute an operating unit or system.

## Acquisition of Real Estate

The Act empowers TVA to acquire real estate in the name of the United States of America by purchase or by exercise of the right of eminent domain, "and thereupon all such real estate shall be entrusted to the Corporation as the agent of the United States to accomplish the purposes of [the] Act". Nearly all of TVA's properties, including powerhouses and transmission line rights-of-way, constitute real estate, title to which is held in the name of the United States and entrusted to TVA as agent of the United States. Thus, you should read and construe all references in this Statement to TVA properties, and to the amounts invested in TVA properties, in the light of this provision of the Act.

## THE BASIC RESOLUTION; POWER BONDS, DISCOUNT NOTES AND OTHER INDEBTEDNESS

TVA issues Power Bonds pursuant to Section 15d of the Act and pursuant to the Basic Resolution. At December 31, 1998, TVA had U.S. \$22.0 billion, DM 1.5 billion (issued in September 1996) and £200 million (issued in December 1998) principal amount of Power Bonds outstanding. TVA may issue Power Bonds only to provide capital for TVA's power program (including refunding any Evidences of Indebtedness issued for like purposes) and only as authorized by law at the time of issuance. Power Bonds are payable as to both principal and interest solely from Net Power Proceeds, but TVA may, at its option, pay Power Bonds from the proceeds of refunding obligations or other funds legally available for such payment. *Power Bonds are not obligations of, or guaranteed by, the United States of America.* Net Power Proceeds for fiscal 1998, 1997, and 1996 were \$3.2 billion, \$2.9 billion and \$2.9 billion, respectively. Power Bonds of each series must be further authorized by Supplemental Resolution.

TVA intends from time to time to issue New Power Bonds with maturities and on terms determined in light of market conditions at the time of sale. TVA may sell New Power Bonds to dealers or underwriters, who may resell the New Power Bonds in public offerings or otherwise. Additionally, TVA may sell New Power Bonds directly or through other entities.

The offering circular, and any appropriate amendment or supplement to the offering circular,

for each offering of New Power Bonds, except for FISBS, will set forth the following information: (1) the aggregate principal amount, (2) maturity, (3) interest rate or method for determining such rate, (4) interest payment dates, if any, (5) purchase price to be paid to TVA, (6) any terms for redemption or other special terms, (7) form and denomination of New Power Bonds, (8) information as to any stock exchange listing, (9) the names of any dealers, underwriters or agents, (10) a description of any amendments or supplements to the Basic Resolution in connection with the sale of the New Power Bonds and (11) other terms of the New Power Bonds.

FISBS are New Power Bonds that TVA may issue from time to time in installments with maturities from one year to fifty years. TVA may offer FISBS for sale from time to time to members of a group of securities dealers selected by TVA, who will resell the FISBS. The aggregate principal amount of all Installment Bonds outstanding at any one time will not exceed \$4 billion. The maximum effective rate payable on any Installment Bonds will not exceed 10 percent. Information relating to FISBS will be set forth in an Installment Bonds offering circular and in any appropriate amendments or supplements to the offering circular. At the time of each sale, TVA will determine if the FISBS being sold will be subject to redemption prior to the maturity date and will establish the purchase price, principal amount, interest rate or interest rate formula, maturity date and certain other terms of such sale.

TVA also issues Discount Notes pursuant to Section 15d of the Act and in accord with Section 2.5 of the Basic Resolution. As of December 31, 1998, TVA had approximately \$2.1 billion in Discount Notes outstanding. Discount Notes are payable solely from Net Power Proceeds, but TVA may, at its option, pay Discount Notes from the proceeds of refunding obligations or other funds legally available for such payment. *Discount Notes are not obligations of, or guaranteed by, the United States of America.* TVA intends to offer Discount Notes for sale on a continuous basis to a group of securities dealers selected by TVA, who will resell

the notes. TVA will issue Discount Notes in a form and upon terms and conditions as it deems appropriate. Certain information respecting Discount Notes will be set forth in a Discount Notes offering circular and any appropriate supplement to the offering circular.

TVA from time to time may issue Other Indebtedness, in addition to New Power Bonds and Discount Notes, to assist in financing its Power Program. TVA issues Other Indebtedness, such as Quarterly Income Debt Securities ("QIDS"), pursuant to Section 15d of the Act and under appropriate authorizing resolutions. At December 31, 1998, TVA had outstanding \$1.1 billion principal amount of QIDS. TVA may issue subordinated debt securities, such as QIDS, from time to time with maturities and on terms determined in light of market conditions at the time of sale. TVA may sell subordinated debt securities to dealers or underwriters, who may resell them in public offerings or otherwise. Additionally, TVA may sell subordinated debt securities directly or through other entities. TVA subordinated debt securities will be payable as to both principal and interest solely from Net Power Proceeds, but TVA may, at its option, pay subordinated debt securities from the proceeds of refunding obligations or other funds legally available for such payment. *Subordinated debt securities are not obligations of, or guaranteed by, the United States of America.*

An offering circular, and any appropriate amendment or supplement to the offering circular, for each offering of Other Indebtedness will set forth the following information: (1) the aggregate principal amount, (2) maturity, (3) interest rate or method for determining such rate, (4) interest payment dates, if any, (5) purchase price to be paid to TVA, (6) any terms for redemption or other special terms, (7) form and denomination of Other Indebtedness, (8) information as to any stock exchange listing, (9) the names of any dealers, underwriters or agents and (10) other terms of the Other Indebtedness. *Other Indebtedness will not be obligations of, or guaranteed by, the United States of America.*

*The following summary of certain provisions of the Basic Resolution is **not complete** and is qualified in its entirety by reference to the full text of the Basic Resolution. See also "Recent Legislation".*

#### **Application of Net Power Proceeds**

*Section 2.3 of the Basic Resolution provides as follows:*

Net Power Proceeds shall be applied, and the Corporation hereby specifically pledges them for application, first to payments due as interest on Bonds, on Bond Anticipation Obligations, and on any Evidences of Indebtedness issued pursuant to Section 2.5 which rank on a parity with Bonds as to interest; to payments of the principal due on Bonds for the payment of which other provisions have not been made; and to meeting requirements of sinking funds or other analogous funds under any Supplemental Resolutions. The remaining Net Power Proceeds shall be used only for:

(a) Required interest payments on any Evidences of Indebtedness issued pursuant to Section 2.5 which do not rank on a parity with Bonds as to interest.

(b) Required payments of or on account of principal of any Evidences of Indebtedness other than Bonds.

(c) Minimum payments into the United States Treasury required by the Act in repayment of and as a return on the Appropriation Investment.

(d) Investment in Power Assets, additional reductions of the Corporation's capital obligations, and other lawful purposes related to the Power Program; provided, however, that payments into the United States Treasury in any fiscal year in reduction of the Appropriation Investment in addition to the minimum amounts required for such purpose by the Act may be made only if there is a net reduction during such year in the dollar amount of outstanding Evidences of Indebtedness issued for capital purposes, and only to such extent that the percentage of aggregate reduction in the Appropriation Investment during such year does not exceed the percentage of net reduction during the year in the dollar amount of outstanding Evidences of Indebtedness issued for capital purposes.

*Section 2.4 of the Basic Resolution provides as follows:*

The Corporation, having first adopted a Supplemental Resolution authorizing the issuance of a series of Bonds and pending such issuance, may issue Bond Anticipation Obligations and renewals thereof (including Interim Obligations to the Secretary of the Treasury) to be paid from the proceeds of such series of Bonds when issued or from other funds that may be available for that purpose.

*Section 2.5 of the Basic Resolution provides as follows:*

To assist in financing its Power Program the Corporation may issue Evidences of Indebtedness other than Bonds and Bond Anticipation Obligations, which may be payable out of Net Power Proceeds subject to the provisions of Section 2.3 hereof, but no such other Evidences of Indebtedness shall rank on a parity with or ahead of the Bonds as to payments on account of the principal thereof or rank ahead of the Bonds as to payments on account of the interest thereon.

See "Amendments to the Basic Resolution to Become Effective in the Future" for a discussion of amendments that will affect the above provisions of Sections 2.3 and 2.5 of the Basic Resolution. See "Recent Legislation" for a discussion of legislation relating to appropriations for TVA's nonpower programs and the funding of such programs, including the use of power revenues.

#### **Rate Covenant**

*Section 3.2 of the Basic Resolution provides as follows:*

The Corporation shall fix, maintain, and collect rates for power sufficient to meet in each fiscal year the requirements of that portion of the present subsection (f) of section 15d of the Act which reads as follows:

The Corporation shall charge rates for power which will produce gross revenues sufficient to provide funds for operation, maintenance, and administration of its power system; payments to States and counties in lieu of taxes; debt service on outstanding bonds, including provision and maintenance of reserve funds and other funds established in connection

therewith; payments to the Treasury as a return on the appropriation investment pursuant to subsection (e) hereof; payment to the Treasury of the repayment sums specified in subsection (e) hereof; and such additional margin as the Board may consider desirable for investment in power system assets, retirement of outstanding bonds in advance of maturity, additional reduction of appropriation investment, and other purposes connected with the Corporation's power business, having due regard for the primary objectives of the Act, including the objective that power shall be sold at rates as low as are feasible.

For purposes of this Resolution, "debt service on outstanding bonds," as used in the above provision of the Act, shall mean for any fiscal year the sum of all amounts required to be (a) paid during such fiscal year as interest on Evidences of Indebtedness, (b) accumulated in such fiscal year in any sinking or other analogous fund provided for in connection with any Evidences of Indebtedness, and (c) paid in such fiscal year on account of the principal of any Evidences of Indebtedness for the payment of which funds will not be available from sinking or other analogous funds, from the proceeds of refunding issues, or from other sources; provided, however, that for purposes of clause (c) of this definition Bond Anticipation Obligations and renewals thereof shall be deemed to mature in the proportions and at the times provided for paying or setting aside funds for the payment of the principal of the authorized Bonds in anticipation of the issuance of which such Bond Anticipation Obligations were issued.

The rates for power fixed by the Corporation shall also be sufficient so that they would cover all requirements of the above-quoted provision of subsection (f) of section 15d of the Act if, in such requirements, there were substituted for "debt service on outstanding bonds" for any fiscal year the amount which if applied annually for 35 years would retire, with interest at the rates applicable thereto, the originally issued amounts of all series of Bonds and other Evidences of Indebtedness, any part of which was outstanding on October 1 of such year.

### **Covenant for Protection of Bondholders' Investment**

Under the Act and Section 3.3 of the Basic Resolution, TVA must, in each successive 5-year period beginning October 1, 1960, use an amount of Net Power Proceeds at least equal to the sum of (1) depreciation accruals and other charges representing the amortization of capital expenditures and (2) the net proceeds from any disposition of power facilities for either (a) the reduction of its capital obligations (including Evidences of Indebtedness and the Appropriation Investment) or (b) investment in Power Assets.

### **Depreciation**

The Basic Resolution requires TVA to accrue, in accordance with a recognized method, annual amounts for depreciation of its power properties (except land and other nondepreciable property) that will amortize their original cost less anticipated net salvage value within their expected useful lives. TVA has provided allowances for depreciation of its power properties (except land and other nondepreciable property) on a straight-line basis during their expected useful lives.

### **Issuance of Additional Bonds and Other Evidences of Indebtedness**

The Act limits the issuance of Evidences of Indebtedness by TVA to a total of \$30 billion outstanding at any one time. At December 31, 1998, TVA had approximately U.S.\$25.2 billion, DM 1.5 billion (issued in September 1996) and £200 million (issued in December 1998) of Evidences of Indebtedness outstanding. In connection with the issuance of TVA's DM and British pound sterling indebtedness, TVA entered into currency swap agreements to hedge its foreign currency exposure. The Basic Resolution and the Act permit the issuance of Power Bonds only to provide capital for TVA's power program, including the refunding of any Evidences of Indebtedness issued for that purpose.

Power Bonds, the terms and conditions of which may not be inconsistent with the Basic Resolution, must also be authorized by Supplemental Resolution. The Basic Resolution provides that each Supplemental Resolution authorizing the issuance of Power Bonds must contain a finding by the Board that after the authorized Power Bonds have been issued, gross revenues from TVA's power pro-



gram will be adequate to meet the requirements of the Basic Resolution with respect to rates and the application of depreciation accruals. These requirements are described under “The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness” — “Rate Covenant” and “Covenant for Protection of Bondholders’ Investment”.

TVA may not increase the amount of Power Bonds outstanding unless net power income (*after* interest expense and depreciation charges *but before* payments as a return on or in reduction of the Appropriation Investment) for the latest five fiscal years has aggregated at least \$200 million. More-over, that minimum requirement is increased by \$15 million for each  $\frac{1}{4}$  percent (or major fraction thereof) by which the average for those five years of the October 1 average interest rate payable by the United States Treasury upon its total marketable public obligations exceeds  $3\frac{1}{4}$  percent. See Section 3.4 of the Basic Resolution and “The Basic Resolution; Power Bonds, Discount Notes and Other Indebtedness” — “Amendments to the Basic Resolution to Become Effective in the Future”.

Pending the issuance of Power Bonds authorized by a Supplemental Resolution, TVA may issue Bond Anticipation Obligations and renewals of Bond Anticipation Obligations (including Interim Obligations to the Secretary of the Treasury), to be paid from the proceeds of such Power Bonds when issued or from other funds that may be available for that purpose.

TVA may also issue Evidences of Indebtedness other than Power Bonds and Bond Anticipation Obligations, such as Discount Notes, to assist in financing TVA’s power program. They may be payable out of Net Power Proceeds subject to the provisions of Section 2.3 of the Basic Resolution. They may not rank on a parity with or ahead of the Power Bonds as to principal or ahead of them as to interest. See “Amendments to the Basic Resolution to Become Effective in the Future”.

### **Mortgaging and Disposal of Power Properties**

TVA may not mortgage any part of its power properties and may not dispose of all or any substantial portion of these properties unless it provides for a continuance of the interest, principal and sinking fund payments due and to become due on all outstanding Evidences of Indebtedness, or for the retirement of such Evidences of Indebtedness.

### **Modifications of Resolutions and Outstanding Bonds**

The Basic Resolution provides for amendments to it, to any Supplemental Resolution and to any outstanding Power Bonds. Generally, TVA may make amendments to the respective rights and obligations of TVA and the bondholders with the written consent of the holders of at least  $66\frac{2}{3}$  percent in principal amount of the outstanding Power Bonds to which the amendment applies. However, TVA may not make changes in the maturity, principal amount, redemption premium, or rate of interest or maturity of any interest installment, with respect to any Power Bond, or in the above percentage for any such consent, without the consent of the holder of such Power Bond.

Additionally, TVA may amend the Basic Resolution or any Supplemental Resolution without the consent of the bondholders in order (1) to close the Basic Resolution against the issuance of additional Power Bonds or to restrict such issuance by imposing additional conditions or restrictions; (2) to add other covenants and agreements to be observed by TVA or to eliminate any right, power or privilege conferred upon TVA by the Basic Resolution; (3) to modify any provisions to release TVA from any of its obligations, covenants, agreements, limitations, conditions or restrictions, provided that such modification or release shall not become effective with respect to any Power Bonds issued prior to the adoption of such amendment; (4) to correct any defect, ambiguity or inconsistency in, or to make provisions in regard to matters or questions arising under, the Basic Resolution or any Supplemental Resolution, so long as such amendments are not contrary to, or inconsistent with, the Basic Resolution or such Supplemental Resolution or (5) to make any other modification or amendment which the Board by resolution determines will not materially and adversely affect the interests of holders of the Power Bonds.

### **Events of Default**

Any of the following shall be deemed an Event of Default under the Basic Resolution: (1) default in the payment of the principal or redemption price of any Power Bond when due and payable at maturity, by call for redemption, or otherwise; (2) default in the payment of any installment of interest on any Power Bond when due and payable for more than 30 days or (3) failure of TVA to

duly perform any other covenant, condition or agreement contained in the Power Bonds or in the Basic Resolution or any Supplemental Resolution for 90 days after written notice specifying such failure has been given to TVA by the holders of at least 5 percent in aggregate principal amount of the then outstanding Power Bonds.

Upon any such Event of Default, the holders of the Power Bonds may proceed to protect and enforce their respective rights, subject to the restrictions described below. The holders of at least 5 percent in aggregate principal amount of Power Bonds then outstanding shall, subject to certain restrictions, have the right and power to institute a proceeding (1) to enforce TVA's covenants and agreements, (2) to enjoin any acts in violation of the rights of holders of Power Bonds and (3) to protect and enforce the rights of holders of Power Bonds. Power Bonds do not provide for acceleration upon an Event of Default. Such holders have no right to bring any such action or proceeding against TVA unless they have given TVA written notice of an Event of Default and TVA has had a reasonable opportunity to take appropriate corrective action with respect thereto and has failed or refused to do so.

Holders of a majority in aggregate principal amount of the outstanding Power Bonds have the right to direct the time, method and place of conducting any proceeding for any remedy available and may waive any default and its consequences, except a default in the payment of the principal of, premium, if any, or interest on any Power Bonds.

#### **Amendments to the Basic Resolution to Become Effective in the Future**

On March 25, 1992, TVA adopted a resolution amending the Basic Resolution, entitled "Fourth Amendatory Resolution to Basic Tennessee Valley Authority Power Bond Resolution" (the "Fourth Amendatory Resolution"). The amendments to the Basic Resolution made by the Fourth Amendatory Resolution will become effective only when either (1) all Power Bonds issued prior to the date of adoption of the Fourth Amendatory Resolution cease to be outstanding (which will occur not later than November 15, 2029) or (2) the holders of at least 66⅔ percent of the principal amount of all then outstanding Power Bonds issued prior to the adoption of the Fourth Amendatory Resolution con-

sent in writing to such amendments. When the amendments become effective, they shall apply to all Power Bonds. The holders of Power Bonds offered after March 25, 1992, shall be deemed to have given their consent to the effect that, at any time after the conditions set forth in (1) or (2) above have been met, the amendments to the Basic Resolution made by the Fourth Amendatory Resolution will become effective in the manner provided. No further vote or consent of the holders of Power Bonds offered after March 25, 1992, is required to permit such amendments to the Basic Resolution to become effective.

The Fourth Amendatory Resolution, when effective in accordance with its terms and the terms of the Basic Resolution, as described above, will (1) delete from the Basic Resolution the limitation on issuance of Power Bonds set forth in Section 3.4 thereof and (2) amend the Basic Resolution to permit issuance of other Evidences of Indebtedness under Section 2.5 thereof that rank on a parity with Power Bonds as to principal and interest.

Section 3.4 of the Basic Resolution presently restricts TVA's ability to issue Power Bonds unless net power income (*after* interest expense and depreciation charges *but before* payments as a return on or in reduction of the Appropriation Investment) for the latest five fiscal years has aggregated at least \$200 million. That amount is increased by \$15 million for each ¼ percent (or major fraction thereof) by which the average for those five years of the October 1 average interest rates payable by the United States Treasury upon its total marketable public obligations exceeds ¾ percent. Upon the effectiveness of the Fourth Amendatory Resolution, which eliminates Section 3.4 of the Basic Resolution, Sections 3.5 through 3.10 will be re-numbered as appropriate.

*The foregoing is a brief summary of certain provisions of the Fourth Amendatory Resolution. This summary is **not a full statement of the terms of the Fourth Amendatory Resolution** and is qualified in its entirety by reference to the Fourth Amendatory Resolution. You may obtain copies in reasonable quantity of the Fourth Amendatory Resolution by writing to Tennessee Valley Authority, 400 West Summit Hill Drive, Knoxville, Tennessee 37902, Attention: Vice President and Treasurer, or by calling (423) 632-3366.*



## Recent Legislation

In October 1997, Congress enacted the Energy and Water Development Appropriations Act, 1998, Pub. L. No. 105-62, 111 Stat. 1320, 1338 (1997). The paragraph captioned “TENNESSEE VALLEY AUTHORITY” in Title IV of this act (the “Appropriations Act paragraph”) (1) appropriates \$70 million for TVA’s nonpower programs in fiscal year 1998; (2) anticipates no further appropriations to TVA thereafter and (3) requires TVA, beginning with October 1, 1998, to fund nonpower programs that constitute “essential stewardship activities” with revenues derived from one or more of various sources, including power revenues, notwithstanding provisions of the TVA Act and power bond covenants to the contrary.

The Appropriations Act paragraph states:

For the purpose of carrying out the provisions of the Tennessee Valley Authority Act of 1933, as amended (16 U.S.C. ch. 12A), including hire, maintenance, and operation of aircraft, and purchase and hire of passenger motor vehicles, \$70,000,000, to remain available until expended, of which \$6,900,000 shall be available for operation, maintenance, surveillance, and improvement of Land Between the Lakes; and for essential stewardship activities for which appropriations were provided to the Tennessee Valley Authority in Public Law 104-206, such sums as are necessary in fiscal year 1999 and thereafter, to be derived only from one or more of the following sources: nonpower fund balances and collections; investment returns of the nonpower program; applied programmatic savings in the power and nonpower programs; savings from the suspension of bonuses and awards; savings from reductions in memberships and contributions; increases in collections resulting from nonpower activities, including user fees; or increases in charges to private and public utilities both investor and cooperatively owned, as well as to direct load customers: *Provided*, That such funds are available to fund the

stewardship activities under this paragraph, notwithstanding sections 11, 14, 15, 29, or other provisions of the Tennessee Valley Authority Act, as amended, or provisions of the TVA power bond covenants: *Provided further*, That the savings from, and revenue adjustments to, the TVA budget in fiscal year 1999 and thereafter shall be sufficient to fund the aforementioned stewardship activities such that the net spending authority and resulting outlays for these activities shall not exceed \$0 in fiscal year 1999 and thereafter.

Notwithstanding Public Law 105-62, in October 1998 Congress appropriated \$50 million for TVA’s nonpower programs for fiscal 1999. The President’s budget proposal for fiscal 2000 includes only \$7 million for TVA, which is to be used to manage the Land Between The Lakes recreational area. In accordance with the Appropriations Act paragraph, TVA will fund its essential stewardship activities with funds from its power program (and other available funds) to the extent that Congress does not make appropriations for these activities.

As part of the October 1998 appropriations legislation, Congress also permitted TVA to repurchase all of its outstanding \$3.2 billion in Power Bonds issued to the Federal Financing Bank (the “FFB”) by paying principal and accrued interest only, without obligation to pay any additional amounts under the terms of these Power Bonds. This part of the legislation also requires TVA to apply a certain portion of the interest savings from the repurchase of its FFB Power Bonds to debt reduction. Pursuant to this legislation, TVA repurchased all of its outstanding Power Bonds issued to the FFB using funds obtained from short-term borrowings. TVA has not issued Power Bonds to the FFB since 1991, and this legislation prohibits TVA from doing so in the future.

In January 1999, a bill was introduced in Congress that would repeal the parts of the October 1998 appropriations legislation described above that relate to TVA’s repurchase of its Power Bonds issued to the FFB.

## INDEPENDENT ACCOUNTANTS

The financial statements of TVA at September 30, 1998 and 1997 and for each of the three fiscal years in the period ended September 30, 1998, appended hereto as part of this Information Statement, have been audited by PricewaterhouseCoopers LLP, independent accountants, as set forth in their report, dated October 23, 1998, which report is also appended hereto.

\* \* \* \* \*

Any statements in this Statement involving matters of opinion, regardless of whether expressly so identified, are opinions only and not factual representations. This Statement is not a contract with the purchaser of any of the New Power Bonds, Discount Notes or Other Indebtedness.

This Statement has been approved by a duly authorized officer of the Tennessee Valley Authority.

Tennessee Valley Authority

By:           /s/  JOHN M. HOSKINS          

John M. Hoskins  
*Vice President and Treasurer*

Dated February 16, 1999

**TENNESSEE VALLEY AUTHORITY**  
**FINANCIAL STATEMENTS**  
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# 1998 FINANCIAL STATEMENTS

## BALANCE SHEETS

At September 30

	Power program		All programs	
	1998	1997	1998	1997
	(in millions)			
ASSETS				
Current Assets				
Cash and cash equivalents .....	\$ 391	\$ 299	\$ 451	\$ 374
Accounts receivable .....	796	701	796	707
Inventories at average cost and other				
Fuel .....	153	112	153	112
Other .....	316	287	316	287
Total current assets .....	1,656	1,399	1,716	1,480
Property, Plant, and Equipment				
Completed plant .....	29,055	28,528	30,166	29,632
Less accumulated depreciation .....	(7,945)	(7,178)	(8,243)	(7,469)
Net completed plant .....	21,110	21,350	21,923	22,163
Construction in progress .....	548	605	558	622
Deferred nuclear generating units .....	6,311	6,303	6,311	6,303
Nuclear fuel and capital leases .....	922	1,040	922	1,040
Total property, plant, and equipment .....	28,891	29,298	29,714	30,128
Investment Funds .....	578	561	578	561
Deferred Charges and Other Assets				
Loans and other long-term receivables .....	104	121	151	170
Debt issue and reacquisition costs .....	861	1,096	861	1,096
Other deferred charges .....	1,525	1,209	1,525	1,209
Total deferred charges and other assets .....	2,490	2,426	2,537	2,475
Total assets .....	<u>\$33,615</u>	<u>\$33,684</u>	<u>\$34,545</u>	<u>\$34,644</u>
LIABILITIES AND PROPRIETARY CAPITAL				
Current Liabilities				
Accounts payable .....	\$ 521	\$ 468	\$ 538	\$ 487
Accrued liabilities .....	175	161	180	172
Accrued interest .....	487	499	487	499
Discount notes .....	1,757	2,151	1,757	2,151
Current maturities of long-term debt .....	1,500	574	1,500	574
Total current liabilities .....	4,440	3,853	4,462	3,883
Other Liabilities .....	2,007	1,704	2,007	1,704
Long-Term Debt				
Public bonds — senior .....	19,127	20,354	19,127	20,354
Federal Financing Bank — senior .....	3,200	3,200	3,200	3,200
Public bonds — subordinated .....	1,100	1,100	1,100	1,100
Unamortized discount and other adjustments .....	(407)	(502)	(407)	(502)
Total long-term debt .....	23,020	24,152	23,020	24,152
Proprietary Capital				
Appropriation investment .....	568	588	4,936	4,887
Retained earnings reinvested in power program .....	3,580	3,387	3,580	3,387
Accumulated net expense of nonpower programs .....	—	—	(3,460)	(3,369)
Total proprietary capital .....	4,148	3,975	5,056	4,905
Total liabilities and proprietary capital .....	<u>\$33,615</u>	<u>\$33,684</u>	<u>\$34,545</u>	<u>\$34,644</u>

The accompanying notes are an integral part of these financial statements.

**1998 FINANCIAL STATEMENTS**  
**STATEMENTS OF INCOME — POWER PROGRAM**  
**For the Years Ended September 30**

	<u>1998</u>	<u>1997</u>	<u>1996</u>
	(in millions)		
<b>Operating Revenues</b>			
Sales of electricity			
Municipalities and cooperatives . . . . .	\$5,554	\$4,811	\$4,980
Industries directly served . . . . .	523	464	452
Federal agencies and other . . . . .	556	561	430
Other revenue . . . . .	<u>96</u>	<u>98</u>	<u>89</u>
Total operating revenues . . . . .	6,729	5,934	5,951
<b>Operating Expenses</b>			
Fuel and purchased power . . . . .	1,900	1,593	1,536
Operating and maintenance . . . . .	1,347	1,201	1,218
Depreciation and amortization . . . . .	1,038	1,014	904
Tax-equivalents . . . . .	<u>264</u>	<u>272</u>	<u>256</u>
Total operating expenses . . . . .	4,549	4,080	3,914
<b>Operating Income</b> . . . . .	2,180	1,854	2,037
Other income (expense), net . . . . .	<u>12</u>	<u>157</u>	<u>(10)</u>
Income before interest expense . . . . .	2,192	2,011	2,027
<b>Interest Expense</b>			
Interest on debt . . . . .	1,930	1,993	1,965
Amortization of debt discount, issue, and reacquisition costs, net . . . . .	84	91	118
Allowance for funds used during construction . . . . .	<u>(55)</u>	<u>(81)</u>	<u>(117)</u>
Net interest expense . . . . .	1,959	2,003	1,966
<b>Net income</b> . . . . .	<u>\$ 233</u>	<u>\$ 8</u>	<u>\$ 61</u>

The accompanying notes are an integral part of these financial statements.



**1998 FINANCIAL STATEMENTS**  
**STATEMENTS OF CASH FLOWS**  
**For the Years Ended September 30**

	Power program			All programs		
	1998	1997	1996	1998	1997	1996
	(in millions)					
<b>Cash Flows from Operating Activities</b>						
Net power income .....	\$ 233	\$ 8	\$ 61	\$ 233	\$ 8	\$ 61
Net expense of nonpower programs .....	—	—	—	(91)	(121)	(127)
Items not requiring (providing) cash						
Depreciation and amortization .....	1,090	1,066	924	1,103	1,080	938
Allowance for funds used during construction .....	(55)	(81)	(117)	(55)	(81)	(117)
Nuclear fuel amortization .....	264	196	156	264	196	156
Other, net .....	(2)	(151)	162	9	(151)	164
Changes in current assets and liabilities						
Accounts receivable .....	(95)	(24)	(1)	(89)	(21)	7
Inventories and other .....	(72)	(19)	(22)	(72)	(19)	(22)
Accounts payable and accrued liabilities ..	72	56	(246)	59	52	(250)
Accrued interest .....	(11)	1	43	(11)	1	43
Other .....	(30)	14	(50)	(36)	14	(50)
Net cash provided by operating activities ...	1,394	1,066	910	1,314	958	803
<b>Cash Flows from Investing Activities</b>						
Construction expenditures .....	(637)	(722)	(1,107)	(642)	(733)	(1,121)
Allowance for funds used during construction .....	55	81	117	55	81	117
Nuclear fuel .....	(151)	(159)	(76)	(151)	(159)	(76)
Proceeds from sale of investments .....	—	513	—	—	513	—
Purchases of investments .....	—	(483)	(162)	—	(483)	(162)
Proceeds from sale of loans receivable .....	—	211	—	—	211	—
Other, net .....	(9)	(21)	(26)	(8)	(13)	(13)
Net cash used in investing activities .....	(742)	(580)	(1,254)	(746)	(583)	(1,255)
<b>Cash Flows from Financing Activities</b>						
Long-term debt						
Issues .....	4,625	3,100	4,400	4,625	3,100	4,400
Redemptions .....	(4,930)	(3,829)	(2,706)	(4,930)	(3,829)	(2,706)
Short-term borrowings, net .....	(394)	377	(1,057)	(394)	377	(1,057)
Debt issue and reacquisition costs, net .....	199	(12)	(44)	199	(12)	(44)
Congressional appropriations .....	—	—	—	69	106	109
Payments to U.S. Treasury .....	(60)	(61)	(63)	(60)	(61)	(63)
Net cash (used in) provided by financing activities .....	(560)	(425)	530	(491)	(319)	639
Net change in cash and cash equivalents .....	92	61	186	77	56	187
Cash and cash equivalents at beginning of period .....	299	238	52	374	318	131
<b>Cash and Cash Equivalents at End of Period</b>	<u>\$ 391</u>	<u>\$ 299</u>	<u>\$ 238</u>	<u>\$ 451</u>	<u>\$ 374</u>	<u>\$ 318</u>

The accompanying notes are an integral part of these financial statements.

**1998 FINANCIAL STATEMENTS  
POWER PROGRAM**

**STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL  
For The Years Ended September 30**

	<u>1998</u>	<u>1997</u>	<u>1996</u>
		(in millions)	
Retained earnings reinvested at beginning of period . . . . .	\$3,387	\$3,420	\$3,402
Net income . . . . .	233	8	61
Return on appropriation investment . . . . .	<u>(40)</u>	<u>(41)</u>	<u>(43)</u>
<b>Retained Earnings Reinvested at End of Period . . . . .</b>	<b>3,580</b>	<b>3,387</b>	<b>3,420</b>
Appropriation investment at beginning of period . . . . .	588	608	628
Return of appropriation investment . . . . .	<u>(20)</u>	<u>(20)</u>	<u>(20)</u>
Appropriation investment at end of period . . . . .	<u>568</u>	<u>588</u>	<u>608</u>
<b>Proprietary Capital at End of Period . . . . .</b>	<b><u>\$4,148</u></b>	<b><u>\$3,975</u></b>	<b><u>\$4,028</u></b>

**NONPOWER PROGRAMS**

**STATEMENTS OF NET EXPENSE  
For the Years Ended September 30**

	<u>1998</u>	<u>1997</u>	<u>1996</u>
		(in millions)	
Water and Land Stewardship . . . . .	\$ 65	\$ 78	\$ 75
Land Between The Lakes . . . . .	8	7	7
Economic Development . . . . .	8	22	25
Environmental Research Center . . . . .	<u>10</u>	<u>14</u>	<u>20</u>
<b>Net Expense . . . . .</b>	<b><u>\$ 91</u></b>	<b><u>\$ 121</u></b>	<b><u>\$ 127</u></b>

**NONPOWER PROGRAMS**

**STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL  
For the Years Ended September 30**

	<u>1998</u>	<u>1997</u>	<u>1996</u>
		(in millions)	
Proprietary capital at beginning of period . . . . .	\$ 930	\$ 944	\$ 964
Congressional appropriations . . . . .	69	106	109
Net expense . . . . .	(91)	(121)	(127)
Other, net . . . . .	<u>—</u>	<u>1</u>	<u>(2)</u>
<b>Proprietary Capital at End of Period . . . . .</b>	<b><u>\$ 908</u></b>	<b><u>\$ 930</u></b>	<b><u>\$ 944</u></b>

The accompanying notes are an integral part of these financial statements.

## NOTES TO FINANCIAL STATEMENTS

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### General

TVA is a wholly owned corporate agency and instrumentality of the United States. It was established by the TVA Act with the objective of developing the resources of the Tennessee Valley region in order to strengthen the regional and national economy and the national defense by providing:

(1) an ample supply of power within the region, (2) navigable channels and flood control for the Tennessee River System, and (3) agricultural and industrial development and improved forestry in the region. TVA carries out these regional and national responsibilities in a service area that centers on Tennessee and parts of Alabama, Georgia, Kentucky, Mississippi, North Carolina and Virginia.

TVA's programs are divided into two types of activities — the power program and the nonpower programs. Substantially all TVA revenues and assets are attributable to the power program. The power program has historically been separate and distinct from the nonpower programs and is required to be self-supporting from power revenues and proceeds from the issuance of debt. The power program receives no congressional appropriations and is required to make annual payments to the U.S. Treasury in repayment of, and as a return on, the government's appropriation investment in TVA power facilities. Most of the funding for TVA's nonpower programs has historically been provided by congressional appropriations. Certain nonpower activities are also funded by various revenues and user fees. Financial accounts for the power and nonpower programs are kept separately.

Power rates are established by the TVA Board of Directors as authorized by the TVA Act. The TVA Act requires TVA to charge rates for power that, among other things, will produce gross revenues sufficient to provide funds for operation, maintenance, and administration of its power system; payments to states in lieu of taxes; and debt service on outstanding indebtedness.

#### Fiscal year

Unless otherwise indicated, years (1998, 1997, etc.) refer to TVA's fiscal years ended September 30.

#### Revenue

Revenues from power sales are recorded as power is delivered to customers. TVA accrues estimated unbilled revenues for power sales provided to customers for the period of time from the end of the billing cycle to month-end.

Off-system sales are presented in the accompanying statements of income-power program as a component of Sales of electricity — Federal agencies and other. Prior to 1998, off-system sales and purchases under exchange power agreements were reflected on a net basis in fuel and purchased power expense. Off-system sales for 1997 and 1996 have been reclassified to conform with the 1998 presentation.

#### Property, plant and equipment, and depreciation

Additions to plant are recorded at cost, which includes direct and indirect costs and an allowance for funds used during construction. The cost of current repairs and minor replacements is charged to operating expense. The TVA Act requires TVA's Board of Directors to allocate the cost of completed multi-purpose projects between the power and nonpower programs, subject to the approval of the President of the United States. The original cost of property retired, together with removal costs less salvage value, is charged to accumulated depreciation. Depreciation is generally computed on a straight-line basis over the estimated service lives of the various classes of assets. Depreciation expense expressed as a percentage of the average annual depreciable completed plant was 3.23 percent for 1998 and 3.21 percent for 1997 and 1996.

#### Decommissioning costs

Effective for 1998, TVA changed its method of accounting for decommissioning costs and related liabilities. TVA's current accounting policy recognizes as incurred all obligations related to closure and removal of its nuclear units. The charge to recognize the additional obligation in 1998 was effected through the creation of a regulatory asset. TVA further modified its accounting methodology such that earnings from decommissioning investments, amortization of the decommissioning regulatory asset, and interest expense on the decommissioning liability are deferred (see

## NOTES TO FINANCIAL STATEMENTS — (Continued)

note 9 — Decommissioning costs). The effect of the change was to decrease 1998 depreciation expense approximately \$38 million — primarily due to the deferral of the decommissioning components of earnings, amortization and interest.

During 1997, the excess of decommissioning investment earnings over the annual decommissioning provision was recorded as other income. Of the total investment earnings of \$151 million, \$13 million was recorded as an offset to the decommissioning provision, with the \$138 million excess recorded as other income. During 1996, the annual decommissioning provision of \$30 million exceeded the earnings from decommissioning fund investments of \$17 million and the \$13 million excess was charged to depreciation expense.

### Allowance for funds used during construction

The practice of capitalizing an allowance for funds used during construction is followed in the power program. The allowance is applicable to construction in progress, excluding deferred nuclear generating units.

### Loans and other long-term receivables

In June 1997, TVA entered into a five-year agreement with a bank pursuant to which TVA agreed to sell certain receivables relating to TVA's consumer energy-conservation programs. As of September 30, 1998, approximately \$218 million of the receivables have been sold for proceeds equal to their carrying amount. Under the terms of the agreement, TVA has retained substantially the same risk of credit loss as if the receivables had not been sold and, accordingly, an appropriate liability account has been established.

### Other deferred charges

Deferred charges primarily include prepaid pension costs and regulatory assets capitalized under the provisions of SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. At September 30, 1998, other deferred charges included total unamortized regulatory assets of \$1,260 million — of which \$342 million represents a capitalized interest component of nuclear fuel; \$377 million represents a transition obligation related to the adoption of SFAS No. 112, *Employers Account-*

*ing for Postemployment Benefits*; \$478 million represents an additional obligation related to the closure and removal of nuclear units (see Note 1 — Decommissioning costs); and \$63 million represents TVA's portion of the costs for decommissioning the Department of Energy's (DOE) nuclear waste disposal facility. At September 30, 1997, the unamortized balances of regulatory assets of \$950 million included \$468 million representing a capitalized interest component of nuclear fuel; \$411 million representing a transition obligation related to the adoption of SFAS No. 112; and \$71 million representing TVA's portion of the costs for decommissioning the DOE's nuclear waste disposal facility. These regulatory assets have historically been amortized over periods ranging from eight to 15 years, generally on a straight-line basis.

### Investment funds

Investment funds consist primarily of a portfolio of investments in trusts designated for funding nuclear decommissioning requirements (see note 9). These funds are invested in portfolios generally designed to earn returns in line with overall equity market performance.

### Debt issue and reacquisition costs

Issue and reacquisition expenses, call premiums and other related costs are deferred and amortized (accrued), respectively, on a straight-line basis over the term of the related outstanding securities.

TVA has incurred premiums related to certain advanced refundings, and also received premiums from the monetization of certain call provisions. In accordance with regulatory practices, TVA has deferred these premiums and is amortizing such premiums ratably through the maturity dates of the new debt issues. The unamortized balances of such regulatory assets at September 30, 1998 and 1997 were \$674 million and \$983 million, respectively.

### Tax-equivalents

The TVA Act requires TVA to make payments to states and local governments in which the power operations of the corporation are conducted. The basic amount is 5 percent of gross revenues from the prior years' sale of power to other than federal

## NOTES TO FINANCIAL STATEMENTS — (Continued)

agencies and interchange sales with other utilities, with the provision for minimum payments under certain circumstances.

### Interest and capital costs

During 1998, 1997, and 1996, cash paid for interest on outstanding indebtedness (net of amount capitalized) was \$1,886 million, \$1,911 million, and \$1,805 million, respectively. In addition to paying interest on outstanding indebtedness, the TVA Act requires TVA to make annual payments to the U.S. Treasury. The annual Treasury payments represent a repayment of the original appropriation investment, along with a return on the appropriation investment. TVA paid \$20 million each year for 1998, 1997 and 1996 as a repayment of the appropriation investment. TVA paid \$40 million to the U.S. Treasury in 1998 as a return on the appropriation investment, while paying \$41 million in 1997 and \$43 million in 1996.

### Risk-management activities

TVA is exposed to market risk from changes in interest rates and currency exchange rates. To manage volatility relating to these exposures, TVA has entered into various derivative transactions, principally interest rate swap agreements and foreign currency swap contracts. TVA is exposed to credit losses in the event of nonperformance by counter-parties on the risk-management instruments. TVA monitors such risk and does not believe that there is a significant risk of nonperformance by any of the parties of these instruments.

Additionally, TVA may engage in hedging activities using forwards, futures or options to hedge the impact of market fluctuations on energy commodity prices. TVA currently accounts for these transactions using the deferral method and gains and losses are recognized in the accompanying financial statements when the related hedged transaction occurs. TVA's risk management policies allow the use of derivative financial instruments to manage financial exposures, but prohibits the use of these instruments for speculative or trading purposes.

### Cash and cash equivalents

Cash and cash equivalents include the cash available in commercial bank accounts and U.S. Treasury accounts, as well as short-term securities held for the primary purpose of general liquidity. Such securities mature within three months from the date of acquisition.

### Research and development costs

Expenditures related to research and development costs of new or existing products and processes are expensed as incurred. The amounts charged against income were \$36 million in 1998, \$44 million in 1997, and \$45 million in 1996.

### Insurance

TVA is primarily self-insured for property loss, workers' compensation, general liability, and automotive liability. TVA is also self-insured for health care claims for eligible active and retired employees. Consulting actuaries assist TVA in determining certain liabilities for self-insured claims. TVA maintains nuclear liability insurance and nuclear property, decommissioning and decontamination insurance with an outside party (see note 9).

### Management estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the related amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### 1999 regulatory and financial reporting accounting changes

The TVA Board of Directors has approved the following accounting changes effective October 1, 1998: 1) Reclassification of an additional \$332 million from nuclear fuel inventory to deferred charges. The regulatory asset will be amortized on a straight-line basis over an estimated three-year period, and interest will no longer be capitalized on TVA's nuclear fuel investment; 2) Maintenance costs incurred during nuclear fuel outages will be



## NOTES TO FINANCIAL STATEMENTS — (Continued)

deferred and amortized on a straight-line basis over the estimated period until the next refueling outage, rather than expensed when incurred; 3) Debt issue and reacquisition costs will be amortized on a pooled basis over the weighted average life of TVA's public debt portfolio, rather than separately amortized over the respective terms of the related outstanding securities; 4) Annual provisions for amortization of deferred charges will be adjusted as necessary in order to achieve certain earnings

levels as set forth in resolutions adopted annually by the TVA Board of Directors in connection with the rate review process. The targeted earnings levels will be based on the earnings requirements of the TVA Act and the Basic TVA Power Bond Resolution (see note 5). Such adjustments may result in either contracting or extending the estimated amortization periods, which range from three to 15 years.

### 2. NUCLEAR POWER PROGRAM

The nuclear power program at September 30, 1998, consists of nine units — five operating, three deferred, and one inoperative — at four locations, with investments in property, plant and equipment as follows and in the status indicated:

	Operating units	Installed capacity (megawatts)	Completed plant, net (dollars in millions)	Construction in progress	Deferred units	Fuel investment
Browns Ferry* .....	2	2,304	\$ 3,328	\$ 50	\$ —	\$337
Sequoyah .....	2	2,442	2,047	37	—	241
Watts Bar .....	1	1,270	6,541	14	1,717	121
Bellefonte .....	—	—	—	—	4,594	—
Raw materials .....	—	—	—	—	—	28
Total .....	<u>5</u>	<u>6,016</u>	<u>\$11,916</u>	<u>\$101</u>	<u>\$6,311</u>	<u>\$727</u>

\* Browns Ferry 1, an inoperative unit, is discussed below

Browns Ferry 1, taken off-line in 1985 for modifications and improvements, will continue to remain in an inoperative status until its ultimate disposition is determined. For financial reporting purposes, the undepreciated cost of Browns Ferry 1 of \$73 million is included in net completed plant and is being depreciated as part of the recoverable cost of the plant over the remaining license period.

Watts Bar 1 began operating commercially during 1996. In 1988, TVA suspended construction activities on Watts Bar 2, and the unit is currently in lay-up. Bellefonte 1 and 2 were deferred in 1988 and 1985, respectively. Estimated 1999 expenditures for the three deferred units total \$10 million and are limited to lay-up, maintenance and ensuring that options remain viable.

In 1993, TVA began an integrated resource planning process to determine TVA's strategy for meeting future customer energy demands. As part of this long-term energy strategy, TVA reevaluated the need for finishing Bellefonte 1 and 2 and Watts

Bar 2 as nuclear units. In December 1994, TVA determined it will not, by itself, complete Bellefonte 1 and 2 and Watts Bar 2 as nuclear units. TVA's IRP identified as a viable option the conversion of the Bellefonte facility to a combined-cycle plant utilizing natural gas or gasified coal. In 1997, an independent team of technical and financial experts completed a feasibility study to evaluate options for the conversion of the Bellefonte Nuclear Plant to a fossil fuel-fired plant. The feasibility study indicates that one of the most economical fossil conversion strategies is to complete Bellefonte as a natural gas-fired combined-cycle plant. TVA also issued an Environmental Impact Statement (EIS) assessing the environmental impacts of various fossil conversion options. The EIS identified the natural gas-fired combined-cycle plant alternative as the preferred option. In addition, TVA submitted a proposal to DOE to complete Bellefonte as a nuclear plant and to operate it to produce tritium for DOE in addition to electricity. Further action will depend on DOE's evaluation of and

## NOTES TO FINANCIAL STATEMENTS — (Continued)

response to the TVA proposal and DOE's other potential options to produce tritium.

While the future decisions on these deferred units will ultimately impact the method of cost

recovery, the TVA Board has determined that it will establish rate adjustments and operating policies to ensure full recovery of the cost of these units and compliance with the requirements of the TVA Act.

### 3. COMPLETED PLANT — POWER PROGRAM

Completed plant of the power program consists of the following at September 30:

	1998			1997		
	Cost	Accumulated depreciation	Net	Cost	Accumulated depreciation	Net
	(in millions)					
Fossil plants.....	\$ 7,780	\$3,181	\$ 4,599	\$ 7,427	\$2,954	\$ 4,473
Nuclear plants.....	14,613	2,697	11,916	14,514	2,277	12,237
Transmission .....	3,265	1,038	2,227	3,144	982	2,162
Hydro plants .....	1,424	491	933	1,382	471	911
Other .....	1,973	538	1,435	2,061	494	1,567
Total.....	<u>\$29,055</u>	<u>\$7,945</u>	<u>\$21,110</u>	<u>\$28,528</u>	<u>\$7,178</u>	<u>\$21,350</u>

### 4. APPROPRIATION INVESTMENT — POWER PROGRAM

The TVA Act requires TVA to make annual payments to the U.S. Treasury from net power proceeds as a return on the appropriations investment in the power system and as a repayment of that investment. The payments required by the TVA Act may be deferred under certain circumstances for not more than two years. The annual repayment amount is \$20 million. The return is based on the appropriation investment as of the beginning of the year and the computed average interest rate payable by the U.S. Treasury on its total marketable public obligations as of the same date (6.71 percent at September 30, 1997.)

### 5. DEBT

#### Borrowing authority

The TVA Act authorizes TVA to issue bonds, notes, and other evidences of indebtedness up to a total of \$30 billion outstanding at any one time. TVA must meet certain cash flow and earnings tests that are contained in the TVA Act and the Basic TVA Power Bond Resolution. Debt service on these obligations, which is payable solely from TVA's net power proceeds, has precedence over the payment to the U.S. Treasury described in note 4.

## NOTES TO FINANCIAL STATEMENTS — (Continued)

### Debt outstanding

Debt outstanding at September 30, 1998 and 1997 consisted of the following:

	1998	1997
	(in millions)	
<b>Short-term debt</b>		
Held by the public		
Discount notes (net of discount) .....	\$ 1,757	\$ 2,151
Current maturities of long-term debt — 5.88% .....	1,500	574
Total short-term debt .....	<u>3,257</u>	<u>2,725</u>
<b>Long-term debt</b>		
Held by the public — senior		
Maturing in 1999 .....	—	2,450
Maturing in 2000 — 6.00% to 8.375% .....	1,250	1,000
Maturing in 2001 — 5.28% to 6.50% .....	2,100	1,800
Maturing in 2002 — 6.875% to 7.45% .....	—	1,500
Maturing in 2003 — 6.125% .....	1,250	1,250
Maturing in years 2004 through 2044 — 5.98% to 8.625% .....	14,527	12,354
Held by Federal Financing Bank — senior		
Maturing in 2003 through 2016 — 8.535% to 11.695% .....	3,200	3,200
Held by the public — subordinated		
Maturing in 2045 through 2046 — 7.50% to 8.00% .....	1,100	1,100
Total long-term debt .....	23,427	24,654
Unamortized discount and other adjustments .....	(407)	(502)
Net long-term debt .....	<u>23,020</u>	<u>24,152</u>
<b>Total debt</b> .....	<u>\$26,277</u>	<u>\$26,877</u>

### Short-term debt

The weighted average rates applicable to short-term debt outstanding in the public market as of September 30, 1998 and 1997, were 5.54 percent and 5.56 percent, respectively. During 1998, 1997, and 1996, the maximum outstanding balance of short-term borrowings held by the public was (in millions) \$2,914, \$3,962, and \$3,537, respectively, and the average amounts (and weighted average interest rates) of such borrowings were approximately (in millions), \$2,234 (5.58 percent), \$2,743 (5.47 percent), and \$2,692 (5.50 percent), respectively.

### Put and call options

Bond issues of \$9.1 billion held by the public are redeemable in whole or in part, at TVA's option, on call dates ranging from the present to July 2020 at call prices ranging from 100 percent to 106.7

percent of the principal amount. During 1998, TVA monetized the call provisions on approximately \$2 billion of public bond issues. Additionally, TVA has bond issues of \$2.1 billion held by the public that are redeemable in whole or in part at the option of the respective bondholders. One bond issue totaling \$500 million, which matures in July 2045, is redeemable in 2001 by the bondholders. A second issue totaling \$121 million, which matures in April 2036, is redeemable in 2006 at the option of the bondholders, and a third issue totaling \$1.5 billion, which matures in April 2036, is redeemable in 1999 or 2006 at the option of the bondholders. A fourth issue totaling \$250 million, which matures in January 2018, includes a provision for a right of redemption upon the death of a beneficial owner in certain specified circumstances. All of these issues are reported in the debt schedule with maturity dates corresponding to the earliest redeemable dates.

## NOTES TO FINANCIAL STATEMENTS — (Continued)

### Bond discount and premium

Discounts and premiums on power borrowings are deferred and amortized (accreted), respectively, as components of interest expense on a straight-line basis over the term of the related outstanding securities.

### Foreign currency transaction and interest rate swap

During 1996, TVA entered into a currency swap contract as a hedge for a foreign currency denominated debt transaction where TVA issued 1.5 billion Deutschemark bonds, the cash flows of which were swapped for those of a U.S. dollar obligation of \$1 billion. Any gain (loss) on the debt instrument due to the foreign currency transaction is offset by a loss (gain) on the swap contract. At September 30, 1998 and 1997 the currency transaction resulted in gains of \$102 million and \$131 million, respectively, which are included in the account “unamortized discount and other adjustments.” The offsetting loss on the swap contract is recorded as a deferred liability. If any loss/gain were to be incurred as a result of the early termination of the swap contract, any resulting charge (income) would be amortized over the remaining life of the bond as a component of interest expense.

Additionally, in 1997, TVA entered into a 10-year fixed rate interest swap agreement with a notional amount of \$300 million. Such agreement was entered into to hedge TVA’s inflation exposure related to its inflation-indexed accreting principal bonds.

### Subsequent event

During October 1998, Congress passed legislation enabling TVA to refinance \$3.2 billion in TVA bonds issued to the Federal Financing Bank. TVA retired these bonds on October 23, 1998, through proceeds from short-term borrowings and expects to refinance on a long-term basis in 1999.

## 6. FAIR VALUE OF FINANCIAL INSTRUMENTS

TVA uses the methods and assumptions described below to estimate the fair values of each significant class of financial instrument.

### Cash and cash equivalents and short-term debt

The carrying amount approximates fair value because of the short-term maturity of these instruments.

### Investment funds

At September 30, 1998, these investments were classified as trading securities and carried at their fair value.

### Loans and other long-term receivables

Fair values for these homogeneous categories of loans and receivables are estimated by determining the present value of future cash flows using the current rates at which similar loans are presently made to borrowers with similar credit ratings and for the same remaining maturities.

### Bonds

Fair value of long-term debt traded in the public market is determined by multiplying the par value of the bonds by the quoted market price (asked price) nearest the balance sheet date. The fair value of other long-term debt and long-term debt held by the Federal Financing Bank is estimated by determining the present value of future cash flows using rates of financial instruments with quoted market prices of similar characteristics and the same remaining maturities.

## NOTES TO FINANCIAL STATEMENTS — (Continued)

The estimated values of TVA's financial instruments at September 30 are as follows:

	1998		1997	
	Carrying amount	Fair amount	Carrying amount	Fair amount
	(in millions)			
Cash and cash equivalents .....	\$ 451	\$ 451	\$ 374	\$ 374
Investment funds .....	578	578	561	561
Loans and other long-term receivables ..	151	151	170	160
Short-term debt .....	1,757	1,757	2,151	2,151
Long-term debt, including current maturities .....	24,927	26,732	25,228	26,127

The fair market value of the financial instruments held at September 30, 1998, may not be representative of the actual gains or losses that will be recorded when these instruments mature or if they are called or presented for early redemption.

### 7. BENEFIT PLANS

#### Pension plan

TVA has a defined benefit plan for most full-time employees that provides two benefit structures, the Original Benefit Structure and the Cash Balance Benefit Structure. The plan assets are primarily stocks and bonds. TVA contributes to the plan such amounts as are agreed upon between TVA and the TVA Retirement System board of directors, which in no event would be less than the amount necessary on an actuarial basis to provide assets sufficient to meet obligations for benefits.

The pension benefit for participants in the Original Benefit Structure is based on the member's

years of creditable service, average base pay for the highest three consecutive years and the pension rate for the member's age and years of service, less a Social Security offset.

The Cash Balance Benefit Structure was implemented January 1, 1996. The pension benefit for participants in the Cash Balance Benefit Structure is based on credits accumulated in the member's account and member's age. A member's account receives credits each pay period equal to 6.0 percent of his or her straight-time earnings. The account also increases at an interest rate equal to the change in the Consumer Price Index plus 3.0 percent, which amounted to 5.82 percent for 1998 and 1997.

During 1998, TVA effected plan amendments such that certain pension benefits were enhanced resulting in approximately \$590 million in additional pension plan benefit obligations.



## NOTES TO FINANCIAL STATEMENTS — (Continued)

The components of pension expense for the years ended September 30 were:

	<u>1998</u>	<u>1997</u> (in millions)	<u>1996</u>
<b>Pension expense:</b>			
Service cost .....	\$ 67	\$ 70	\$ 72
Interest cost on projected benefit obligation .....	328	308	309
Actual return on assets .....	(223)	(1,334)	(616)
Net amortization and deferral .....	(256)	899	217
<b>Net pension income .....</b>	<b><u>\$ (84)</u></b>	<b><u>\$ (57)</u></b>	<b><u>\$ (18)</u></b>
<b>Funded status:</b>			
Actuarial present value of benefit obligations:			
Vested benefit obligation .....	\$(5,098)	\$(3,770)	\$(3,506)
Nonvested benefits .....	(10)	(48)	(50)
Accumulated benefit obligation .....	(5,108)	(3,818)	(3,556)
Effects of projected future compensation .....	(537)	(391)	(401)
Projected benefit obligation .....	(5,645)	(4,209)	(3,957)
Plan assets at fair value .....	5,968	5,962	4,851
Excess of plan assets over projected benefit obligation .....	323	1,753	894
Unrecognized prior service cost .....	470	(7)	(7)
Unrecognized net gain .....	(572)	(1,529)	(763)
Unrecognized net obligation being amortized over 15 years beginning October 1, 1987 .....	—	—	2
<b>Prepaid pension cost .....</b>	<b><u>\$ 221</u></b>	<b><u>\$ 217</u></b>	<b><u>\$ 126</u></b>

The discount rate used to determine the actuarial present value of the projected benefit obligation was 7.0 percent in 1998 and 8.0 percent in 1997 and 1996. The assumed annual rates of increase in future compensation levels for 1998, 1997 and 1996 ranged from 3.3 to 8.3 percent. The expected long-term rate of return on plan assets was 11.0 percent for 1998, 1997, and 1996.

### Other postretirement benefits

TVA sponsors an unfunded defined benefit postretirement plan that provides for contributions toward the cost of retirees' medical coverage. The plan covers employees who, at retirement, are age 60 and older (or who are age 50 and have at least five years of service). TVA's contributions are a flat dollar amount based upon the participants' age and years of service and certain payments toward the plan costs.

In connection with the pension plan benefit amendments, TVA also effected other postretirement benefit plan amendments during 1998 such that certain retiree health benefits were discontinued, resulting in approximately \$120 million in reduced other postretirement benefit obligations.

The annual assumed cost trend for covered benefits is 10.0 percent in 1998, decreasing by one-half percent per year to a level of 5.0 percent in 2008 and thereafter. For 1997 and 1996, an annual trend rate of 10.5 percent and 11.0 percent, respectively, was assumed. The effect of the change in assumptions on a cost basis was not significant. Increasing the assumed healthcare cost trend rates by 1.0 percent would increase the accumulated postretirement benefit obligation (APBO) as of September 30, 1998, by \$17 million and the aggregated service and interest cost components of net periodic postretirement benefit cost for 1998 by \$2 million.

The weighted average discount rate used in determining the APBO was 7.0 percent for 1998 and 8.0 percent for 1997 and 1996. Any net unrecognized gain or loss resulting from experience different from that assumed or from changes in assumptions, in excess of 10.0 percent of the APBO, is amortized over the average remaining service period of active plan participants.

## NOTES TO FINANCIAL STATEMENTS — (Continued)

The following sets forth the plan's funded status at September 30:

	1998	1997	1996
	(in millions)		
<b>Accumulated postretirement benefit obligation (APBO)</b>			
Retirees .....	\$118	\$220	\$230
Fully eligible active plan participants .....	1	2	4
Other active plan participants .....	87	126	187
<b>APBO</b> .....	206	348	421
Unrecognized prior service costs .....	25	—	—
Unrecognized net (loss) gain .....	(5)	—	(95)
<b>Accrued postretirement benefit cost</b> .....	<u>\$226</u>	<u>\$348</u>	<u>\$326</u>
<b>Net periodic postretirement benefit cost</b>			
Service cost .....	\$ 8	\$ 13	\$ 8
Interest cost .....	26	32	24
Amortization of loss .....	—	4	—
<b>Net periodic postretirement benefit cost</b> .....	<u>\$ 34</u>	<u>\$ 49</u>	<u>\$ 32</u>

### Other postemployment benefits

Other postemployment benefits include workers' compensation provided to former or inactive employees, their beneficiaries and covered dependents after employment but before retirement. Adoption of Statement of Financial Accounting Standards No. 112, *Employers Accounting for Post-employment Benefits* (SFAS No. 112) in 1995 changed TVA's method of accounting from recognizing costs as benefits are paid to accruing the expected costs of providing these benefits. This resulted in recognition of an original transition obligation of approximately \$280 million. During 1996, TVA made adjustments to certain assumptions utilized in the determination of the obligation at September 30, 1996, which resulted in an increase in the original transition obligation of approximately \$194 million. In connection with the adoption of SFAS No. 112, and related approval by its Board of Directors, TVA recorded the transition obligation as a regulatory asset. The regulatory asset is being amortized over approximately 15 years, whereby the annual expense will approximate the expense that would be recorded on an as-paid basis.

### Early-out and accelerated severance packages

In 1997 and 1996, TVA provided both voluntary and involuntary severance packages, which affected an aggregate of approximately 2,500 employees. During this period, severance costs totaled

approximately \$48 million and consisted primarily of severance pay (\$75 million) and a related pension curtailment gain of \$27 million. The aggregate costs of the severance packages have been charged to the power program primarily as other expense during 1997 and 1996 in the amounts of \$11 million and \$35 million, respectively, and the nonpower program as nonpower expense during 1997 and 1996 in the amounts of \$8 million and \$6 million, respectively.

## 8. MAJOR CUSTOMERS

One municipal customer accounts for approximately 10 percent of total power sales and four other municipal customers account for an additional aggregate 19 percent of total power sales. These five municipal customers purchase power from TVA under long-term contracts for terms of 20 years, which require a notice of 10 years to terminate.

## 9. CONSTRUCTION EXPENDITURES AND COMMITMENTS AND CONTINGENCIES

### Leases

Certain property, plant and equipment are leased under agreements with terms ranging from one to 30 years. Most of the agreements include purchase options or renewal options that cover substantially all the economic lives of the properties. Obligations under capital lease agreements in effect

## NOTES TO FINANCIAL STATEMENTS — (Continued)

at September 30, 1998, total \$36 million annually through 2003, and an aggregate of \$264 million thereafter, for a total commitment of \$444 million, which includes an interest element of \$249 million.

### Construction expenditures

Construction expenditures, including capitalized interest, are estimated to be approximately \$828 million for 1999 and \$719 million for 2000. These estimates are revised periodically to reflect changes in economic conditions and other factors considered in their determination.

### Fuel purchase commitments

TVA has entered into approximately \$2.6 billion in long-term commitments ranging in terms of up to seven years for the purchase of coal, and approximately \$216 million in long-term commitments ranging in terms of up to five years for the purchase of uranium.

### Contingencies

*Nuclear insurance.* The Price-Anderson Act sets forth an indemnification and limitation of liability plan for the U.S. nuclear industry. All Nuclear Regulatory Commission (NRC) licensees, including TVA, maintain nuclear liability insurance in the amount of \$200 million for each plant with an operating license. The second level of financial protection required is the industry's retrospective assessment plan, using deferred premium charges. The maximum amount of the deferred premium for each nuclear incident is approximately \$88 million per reactor, but not more than \$10 million per reactor may be charged in any one year for each incident. TVA could be required to pay a maximum of \$528 million per nuclear incident on the basis of its six licensed units, but it would have to pay no more than \$60 million per incident in any one year.

In accordance with NRC regulations, TVA carries property and decontamination insurance of \$1.06 billion at each licensed nuclear plant for the cost of stabilizing or shutting down a reactor after an accident. Some of this insurance may require the payment of retrospective premiums of up to a maximum of approximately \$22 million.

*Clean Air legislation.* The Clean Air Act Amendments of 1990 require coal-fired generation

units to reduce their sulfur dioxide and nitrogen oxide emissions in two phases in order to control acid rain. The Phase I compliance period commenced on January 1, 1995, for sulfur dioxide and January 1, 1996, for nitrogen oxide, while the Phase II compliance period commences on January 1, 2000. Based on the level of emissions, 26 of TVA's 59 operating coal-fired units are classified as Phase I units, with the remaining units being Phase II units. Compliance with these requirements has resulted in substantial expenditures for the reduction of emissions at TVA's coal-fired generating plants.

TVA's strategy for complying with the 1990 Amendments includes the use of scrubbers at two fossil units and the use of lower-sulfur coal at other fossil units to reduce sulfur dioxide. TVA has completed all planned scrubbers and is on schedule to complete the change-over to lower-sulfur coal.

Nitrogen oxide reductions were required for 19 of TVA's Phase I units. These reductions were achieved through the installation of low-nitrogen-oxide burners at 13 units. TVA is in compliance with all Phase I requirements and is currently installing nitrogen oxide reduction equipment to bring TVA's remaining units in compliance with Phase II nitrogen oxide emission requirements.

Expenditures related to the Clean Air projects during 1998 and 1997 were approximately \$64 million and \$40 million, respectively. TVA has already completed the actions necessary to achieve Phase I compliance for both sulfur dioxide and nitrogen oxide emissions, and TVA is proceeding to take actions to comply with Phase II requirements that become effective in the year 2000 or after.

The total cost of compliance cannot reasonably be determined at this time because of the uncertainties surrounding emerging Environmental Protection Agency regulations, resultant compliance strategies, potential for development of new emission control technologies and future amendments to the legislation.

*Hazardous substances.* The release and cleanup of hazardous substances are regulated under the Comprehensive Environmental Response, Compensation, and Liability Act. In a manner similar to many other industries and power systems, TVA has generated or used hazardous substances

## NOTES TO FINANCIAL STATEMENTS — (Continued)

over the years. TVA has been identified as a potentially responsible party with respect to five off-site disposal areas. TVA's liability at these sites has not yet been determined. In addition, TVA is currently investigating one other site that TVA owns. TVA may have cleanup responsibilities at this site by virtue of its control of the property. TVA's potential liabilities for its share of cleanup costs at all of these sites are uncertain but are not expected to be substantial.

*Pending litigation.* TVA is a party to various civil lawsuits and claims that have arisen in the ordinary course of its business. Although the outcome of pending litigation cannot be predicted with any certainty, it is the opinion of TVA counsel that the ultimate outcome should not have a material adverse effect on TVA's financial position or results of operations.

*Decommissioning costs.* Provision for decommissioning costs of nuclear generating units is based on the estimated cost to dismantle and decontaminate the facilities to meet NRC criteria for license termination. The Financial Accounting Standards Board (FASB) has reached several tentative conclusions with respect to its project regarding the accounting for closure and removal of long-lived assets, including the decommissioning of nuclear generating units. It is uncertain when the final statement will be issued and what impact it may ultimately have on TVA's financial position or results of operations. Effective for 1998, TVA changed its method of accounting for decommissioning costs and related liabilities in order to comply with certain of the FASB's tentative conclusions, as well as certain rate-setting actions.

TVA's current accounting policy recognizes as incurred all obligations related to closure and removal of its nuclear units. The liability for closure is measured as the present value of the estimated cash flows required to satisfy the related obligation and discounted at a determined risk-free rate of interest. The corresponding charge to recognize the additional obligation was effected through the creation of a regulatory asset. TVA further modified its method of accounting for decommissioning costs such that earnings from decommissioning fund investments, amortization expense of the decommissioning regulatory asset, and interest expense on the decommissioning liability are deferred in accor-

dance with SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. At September 30, 1998, the present value of the estimated future decommissioning cost of \$814 million was included in other liabilities. The decommissioning cost estimates from a 1995 study are based on prompt dismantlement and removal of the plant from service. The actual decommissioning costs may vary from the estimates because of changes in the assumed dates of decommissioning, changes in regulatory requirements, changes in technology and changes in the cost of labor, materials and equipment.

TVA maintains an investment trust fund to provide funding for the decommissioning of nuclear power plants. In May 1997, TVA sold the entire \$402 million equity index fund portfolio and transferred the proceeds to trust portfolios managed by independent money managers. During 1997, TVA recognized \$151 million of income related to the fund, which included an \$81 million gain on the sale of fund investments and \$70 million in net appreciation and interest income. As of September 30, 1998, the decommissioning trust fund investments totaled \$571 million and were invested in securities designed to achieve a return in line with overall equity market performance.

Effective September 22, 1998 the NRC amended its regulations regarding decommissioning funding. TVA is studying the change in regulation for potential impacts on both the required amount of funding and the nature of the trust accounts. The new regulation becomes effective on November 23, 1998 and is not expected to have a material impact on TVA's financial position or results of operations.

*Cost-based regulation.* As a regulated entity, TVA is subject to the provisions of SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. Accordingly, TVA records certain assets and liabilities that result from the effects of the ratemaking process that would not be recorded under generally accepted accounting principles for non-regulated entities. Currently, the electric utility industry is predominantly regulated on a basis designed to recover the cost of providing electric power to its customers. If cost-based regulation were to be discontinued in the industry for any reason, profits could be reduced and utilities might

## NOTES TO FINANCIAL STATEMENTS — (Continued)

be required to reduce their asset balances to reflect a market basis less than cost. Discontinuance of cost-based regulation would also require affected utilities to write-off their associated regulatory assets. Such regulatory assets for TVA total approximately \$1.9 billion at September 30, 1998, along with approximately \$6.3 billion of deferred nuclear plants. Management cannot predict the potential impact, if any, of the change in the regulatory environment on TVA's future financial position and results of operations.

### 10. NONPOWER PROGRAMS

TVA's nonpower programs provide various public services, including managing navigable river channels, providing flood control and overseeing certain recreation facilities. The nonpower programs encompass general stewardship of land, water and wildlife resources. TVA's nonpower programs also conduct certain research and development activities in pollution prevention and remediation.

Funding for the nonpower programs has historically been primarily provided through federal appropriations. Certain nonpower program activities are also funded by user fees and outside services revenues. In 1997, Congress passed legislation that anticipated no further appropriations to TVA after 1998 and required TVA to fund its nonpower programs that constitute "essential stewardship activities" from one or more sources, including power revenues. Nonetheless, in October 1998, Congress appropriated \$50 million for TVA's nonpower programs for 1999.

The completed plant of the nonpower programs consists of multipurpose dams and other plant. At September 30, 1998, the net completed plant balances for multipurpose dams and other plant were \$698 million and \$115 million, respectively. At September 30, 1997, the net completed plant balances for multipurpose dams and other plant were \$699 million and \$113 million, respectively.



## REPORT OF INDEPENDENT ACCOUNTANTS

### To the Board of Directors of the Tennessee Valley Authority

In our opinion, the accompanying balance sheets (power program and all programs) and the related statements of income (power program), changes in proprietary capital (power program and nonpower programs), net expense (nonpower programs) and cash flows (power program and all programs) present fairly, in all material respects, the financial position of the power program and all programs of the Tennessee Valley Authority as of September 30, 1998 and 1997, the results of operations of the power program and nonpower programs and cash flows of the power program and all programs for each of the three years in the period ended September 30, 1998, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Tennessee Valley Authority's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards and Government Auditing Standards issued by the Comptroller General of the United States which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

In accordance with Government Auditing Standards, we have also issued a report, dated October 23, 1998, on our consideration of the Tennessee Valley Authority's internal controls over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts and grants.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP  
Knoxville, Tennessee  
October 23, 1998

## REPORT OF MANAGEMENT

Management is responsible for the preparation, integrity and objectivity of the financial statements of the Tennessee Valley Authority as well as all other information contained in the annual report. The financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis and, in some cases, reflect amounts based on the best estimates and judgments of management, giving due consideration to materiality. Financial information contained in the annual report is consistent with that in the financial statements.

The Tennessee Valley Authority maintains an adequate system of internal controls to provide reasonable assurance that transactions are executed in accordance with management's authorization, that financial statements are prepared in accordance with generally accepted accounting principles, and that the assets of the corporation are properly safeguarded. The system of internal controls is documented, evaluated, and tested on a continuing basis. No internal control system can provide absolute assurance that errors and irregularities will not occur due to the inherent limitations of the effectiveness of internal controls; however, management strives to maintain a balance, recognizing that the cost of such a system should not exceed the benefits derived. No material internal control weaknesses have been reported to management.

PricewaterhouseCoopers LLP was engaged to audit the financial statements of the Tennessee Valley Authority and issue reports thereon. Its audits were conducted in accordance with generally accepted auditing standards. Such standards require a review of internal controls and an examination of selected transactions and other procedures sufficient to provide reasonable assurance that the financial statements neither are misleading nor contain material errors. The Report of Independent Accountants does not limit the responsibility of management for information contained in the financial statements and elsewhere in the annual report.

/s/ David N. Smith

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David N. Smith  
Chief Financial Officer  
and Executive Vice President of Financial Services



Certain principles are essential to the protection of the public interest, most notably reliability of service, universal access, environmental responsibility, and the promotion of economic development.



▲ *TVA is the nation's largest wholesale power producer.*



▲ *TVA's electric generation facilities include state of the art computer controlled production.*



▲ *TVA's 17,000-mile system of transmission lines through seven states serves as a vital part of the United States energy infrastructure.*



▲ *TVA is environmentally sensitive in managing the thousands of acres along the Tennessee River system.*



▲ *The energy right® program was developed jointly by TVA and its customers to promote energy conservation through more efficient power use.*



▲ *TVA manages the nation's fifth largest river system for flood control, navigation, power production and recreation.*

